In the Supreme Court of the United States.

OCTOBER TERM, 1897.

No. _____

LACKAWANNA IRON & COAL CO. ET AL,
PETITIONERS,

vs.

FARMERS' LOAN & TRUST COMPANY, ET AL,
RESPONDENTS.

BRIEF FOR MORAN BROS. AND HENRY K. MCHARG, RESPONDENTS, AND INTERVENING BOND HOLDERS, IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

We oppose the petition for *certiorari* on three grounds, as follows:

FIRST. Petitioners' case, as disposed of in the Circuit Court and Circuit Court of Appeals, is not of the class of

cases that come within any rule announced by this Court in which writs of *certiorari* will be granted.

SECOND. Petitioners' case was disposed of in the Circuit Court and Circuit Court of Appeals on the merits, in accordance with principles repeatedly announced and firmly established by this court in similar cases. In other words, the decision is right on the merits, not in conflict with other Federal Court decisions, and the application should be denied.

THIRD. Petitioner's case was disposed of in the Circuit Court and Circuit Court of Appeals on findings of the special master to the effect that petitioners *sold the rails to the railway company on its general credit*; that the *sale was of an unusually large amount of rail*, and that petitioners' *claim could not be classed as a current debt* made in the ordinary course of business, and said findings are not excepted to by petitioners, and there is no evidence in the record so that such findings may be reviewed by this court.

The facts supporting the three objections are so interwoven and connected we find that all can be conveniently presented together.

While the opinion of the Circuit Court of Appeals reviews the leading cases on the subject of preferential claims, in answer to petitioners' various contentions, the case is made to turn in that court, as it turned before the Master and in the Circuit Court, on questions of fact peculiar to this case. The underlying facts upon which the opinion rests are the following facts found by the Circuit Court of Appeals and the Special Master: (Italics in all quotations ours.)

(1) That petitioners' claim is for rails that "were sup-

plied, not as a matter arising in the ordinary course of the railroads operations, *but for the virtual reconstruction of the road.*" This finding is fortified by the facts found by the Master, that the railway purchased, under the contracts set up by petitioners, 18,581 tons of rail, which at the prices agreed to, amounted to the sum of $735,454.30, sufficient rail to lay down new 214 77-100 miles of track, and this entire purchase was made in twelve to fourteen months by a road having only about 500 miles of track. (R. 650 to 655.) (Court's opinion, R. p. —, and 79 Fed. Rep. at top of page 210.) And upon these facts the Court remarks: "No authorities need be cited to establish the proposition that works of reconstruction are not entitled to preferential payment."

(2) "The unusually large purchase of rails; the time within which they were to be delivered; the condition of the road; the contracts providing for notes at six months, renewable for a like term at the makers option; the hypothecation of securities for the payment of the claims; the knowledge which the intervenor had of the mortgage; the fact that the contract contained no promise to pay out of any particular fund; the time which elapsed between the date of the contract and the appointment of the receiver in cause No. 185, are circumstances which, taken together, *cannot fail to convince us that the intervenor relied upon the general credit of the railway company.*" (Court's opinion, R. p. —, and 79 Fed. Rep., p. 210.)

(3) "I find that the debt for which the Lackawanna Company claims payment in its petition, *cannot be classed as current debt made in the ordinary course of business*, as those terms seem generally to be understood." (Master's finding, R. p. 656.)

(4) "I find that * * * *the credit extended* under said contracts *was at the request of and for the accommodation of the defendant* railway company, and *upon its general credit.* That said *sales were made without any stipulation that security should be given* by the defendant company for said rails, *or that payment therefor should be made out of any particular fund or in any particular way;* said *sales were of an unusually large amount of rails,* and defendant was unable to pay cash therefor. That *petitioner* * * * *had knowledge of the mortgage,*" &c. (Master's findings, R. pp. 656 and 657.)

The foregoing are the facts which have controlled the destiny of this case on its way through all the courts. Summarized, these facts read: The railway company's road was run down, and it bought this unusually large amount of rails for the purpose of virtually reconstructing its road, and not as a matter arising in the ordinary operation of the road. That the rails were bought upon the *general credit of the railway company*, and upon a credit to suit the convenience and accommodation of the railway company, without any agreement that payment should be made in any particular manner, or out of any particular fund, and the claim cannot be classed as a current debt.

These findings stand, and must ever stand, unchallenged, because petitioners furnish no way of attacking them. There are, in the first place, no exceptions addressed to them; and in the second place, if there were any such exceptions, this Court could not test their correctness, for the evidence upon which the Master and Circuit Court acted is not in the record. Petitioners surely cannot ask this Court to attack these findings of fact when they have never done so. But this is not all. The decree of the

Circuit Court shows that that Court passed on the *evidence* as well as the Master's report. (R. p. 681.) The evidence is not here. How can that decree be reviewed without it?

Upon this state of the record can it be contended seriously that any question of general importance or of peculiar gravity can arise out of this sale of general merchandise to a railroad company on its general credit for purposes of general reconstruction by a railroad supply creditor? Can there be a doubt in the mind of a single member of this Court that petitioners' claim was properly denied priority over the mortgage bonds, when it appears, without controversy, to be a claim for general merchandise, sold on the general credit of the railway company for the purpose of virtually reconstructing its road, and cannot be classed as a current debt?

We do not understand that this Court desires to re-examine the grounds on which its decisions rest, which hold that claims for general merchandise for purposes of general construction, are entitled to no preference over prior mortgage bonds. It has never been held, within our knowledge, that such claims have any standing under the doctrine of Fosdick vs. Scholl. Will the fact that a claimant asserts that his claim comes within the doctrine of that case, (when he comes here with a claim for general merchandise only) bring his case within the rule of this Court allowing writs of *certiorari*? Can it be seriously contended that this case is one where the decision conflicts with other decisions so that the writ ought to issue "to secure uniformity of decision"? Can there be found in the whole range of cases a single case that gives priority to the character of claim shown by the record in this case?

Counsel for petitioners base their right to a writ of certiorari on the ground, among others, that there is a conflict between this case and that of Southern Railway Co. vs. Carnegie Steel Company, and they argue from this assumed, but unestablished conclusion, that the writ prayed for must be granted in the interest of uniformity of decision. A more indefensible position could hardly be taken than to stand for the proposition that this case is like the Carnegie case, or the Rowena Clark, the other case cited by petitioners. The comparison instituted in the petitioners' application is simply no comparison whatever. Had as well say that two cases involving the title to two horses are the same in principle because each horse has four legs, two eyes and one tail as to say that the two claims asserted by two different intervenors in separate railway receiverships are the same in principle because "both cases involve two successive receiverships, to-wit: First, a receivership instituted, not at the suit of a mortgagee, but at the instance of other creditors, to protect the property from disruption and to hold it together; and thereafter a supervening receivership, provoked by bondholders, and to which the first receivership was made to account. Both cases involved a claim for steel rails, involved a consideration of the effect to be given to the fact that promissory notes were given in evidence of a credit extended for said rails; involved renewals of the notes so given, and involved the alleged laches of the petitioners." (Petition for *certiorari*, p. 23.) We understand that the distinguishing facts in all cases of this character are: Was the debt contracted upon the general credit of the railway company? Were the supplies purchased for, or used in, the general operation of the road, or were the supplies

purchased as general merchandise, or used for purposes of general construction, or the virtual reconstruction of the road? The facts in this case showing petitioner's claim to be for general merchandise sufficiently appears from what has been said.

We now direct attention to the cases referred to by petitioners. We refer, first, to the Carnegie case. In that case, there are no findings of fact that the purchase was "unusually large in amount," or that the purchase was made for "virtually reconstructing the road" or that the rail was sold on the "general credit" of the railway company, or that the claim could not be classed as a "current debt" made in the usual course of business. On the contrary, it is found by Judges Simonton and Morris, both of whom delivered opinions in that case, that the claim of the Carnegie company was a current debt. This fact, that the Carnegie claim was a current debt, together with the further fact that there had been a diversion of the revenue of the road, lay at the very foundation of the case.

A bare reference to the Rowena Clark case will show how different it is to the petitioners' claim. We quote from the opinion stating the nature of the claims in that case. Judge Toumlin, in stating the case, says:

"From what appears in the record we are satisfied that the debts claimed by intervenors for coal delivered prior to the appointment of the receivers were current debts for operating expenses of the Central Railroad lines, made in the ordinary course of business, to be paid out of the current earnings. The coal was purchased in the name of the Central Railroad. It was delivered on its lines and

was furnished for their operation, and with the exception of a small amount was used by them."

In both the Carnegie and Rowena Clark cases, the Circuit Court of Appeals treated the claims as "current debts" contracted in the general operation of the railways. In both cases priority was given the claimants over the mortgaged bonds by the Circuit Court of Appeals, and in both cases at the instance of the railways and other parties adversely interested to the claimants, this honorable court granted writs of certiorari, and that action is cited as a precedent by petitioners, and made the basis and practically the sole ground for the demand that a writ of certiorari be granted in this case, when the claim of petitioners is proven without controversy and treated throughout as a claim for general merchandise, bought for purposes of reconstruction, in an unusally large quantity, and could not be classed as a current debt, and the priority is denied. We judge from the argument and statement of the ground upon which it is asked that the writ of certiorari be granted, that it is supposed this court, having granted writs of certiorari in two cases which involve the rights of claimants seeking priority over mortgage bonds, that the door is thrown wide open—that a general invitation is extended to all who have claims seeking ~~propriety~~ to apply and the prayer of their petitions will be granted, regardless of merit or the correctness of the decision complained of. Had as well assume that this court, having granted its writ in a patent, admiralty or municipal bond case, will grant writs to all comers who can show a patent, admiralty or municipal bond case. This is the sequence of the logic used to obtain the writ prayed for, or counsel seem to think it is necessary that this court have before it

all cases which may be decided by the Circuit Court of Appeals involving claims of priority over railway mortgage bonds before a decision may be reached in the cases in which writs have already been granted. Such a practice would, if logically pursued, result eventually in bringing to this court every case decided by the Circuit Court of Appeals which involved kindred questions to any case in which a certiorari had been granted. We do not understand from the decisions of this court that such has entered into its remotest conception. The rule, as we understand it, is that each case must stand or fall on its own merits. The case presented must show that it, not some other case, presents a question of "peculiar gravity," or "general importance," or "conflict of decisions," among the Federal Courts. We feel warranted in assuming that this court is entirely satisfied with the decisions in the following well considered cases, in all of which claims of the general class asserted by petitioners were denied priority:

Thomas vs. Car Co., 149 U. S. 95.
Bound vs. Ry. Co., 58 Fed. 473.
Hale vs. Frost, 99 U. S. 389.
Heiderkoper vs. Locomotive Works, 99 U. S. 258.
Wood vs. Guarantee Trust Co., 128 U. S. 416.
Kneeland vs. Trust Co., 136 U. S. 89.
Finance Co. vs. Charleston Ry. Co., 10 C. C. A. 323. (s. c.) 62 Fed. Rep., 205.
Railroad Co. vs. Hamilton, 134 U. S. 68.
Railway Co. vs. Cowdry, 11 Wall 482.

Counsel for petitioners also ~~deny~~ rely on that part of the 6th finding of the special master wherein he reports: "That at the time when the contracts hereinbefore mentioned

were enteredinto between the Lackawanna Company and the defendant railway company, that the condition of the track of the defendant railway company was such that the demand for new rails upon the most worn portion of the roadway was practically imperative." Further: "The condition of these roads was bad, except such portions as has been relaid with 5000 tons of rails purchased prior to December 28th, 1882. There was continual breakage of rails and wrecking of trains, the track was unsafe and was generally so regarded not only by railroad men but by the traveling public; the damage to merchandise, rolling stock, etc., was continuous and the need for new rails appears to have been almost absolutely necessary as a preservation of human life, the loss of which was liable to occur any moment." (R. p. 565)

This condition of things is relied on as showing that the rails were needed to keep the road a "going concern." The trouble with the petitioners' case is that these facts prove too much, especially when taken in connection with the other findings of the master referred to above—that the purchase was unusually large in amount, and that the debt could not be classed as a current debt. The purchase seems to have been very suddenly made whereby 18,581 tons of rail were purchased in the very short space of from 12 to 14 months, at a cost of $735,454.30, and which was sufficient in amount to lay down a new track 214.77 miles on the road of a railway company which owned only about 500 miles of road. These facts clearly support the finding of the Circuit Court of Appeals that "the purchase was made to virtually reconstruct the road."

The foregoing discussion precludes the necessity of

giving any special attention to petitioners' claim that the payment of $91,371.00 interest to the mortgage bondholders in May, 1887, by the receiver in cause No. 198 was a division of funds from petitioners' claim justly applicable to it. But we believe we have two sufficient answers to this claim. In the first place, it must be shown that petitioners' claim is of the preferential class before they can avail themselves of the doctrine of diversion, or, in other words, claim that there has been a diversion. We do not understand that a general creditor who is not protected by the peculiar equity which brings his case within the protection of this court is in a position to complain that other creditors have been paid certain amounts on their debts. In the second place, it appears from the master's findings that the accounts of the receivership were not kept in a manner so that it could be determined out of what fund this payment of interest was made. On this subject the master finds:

"I further find that the accounts of said railway company were not kept in such a manner as to indicate the exact fund out of which the interest on said first mortgage bonds of the Waco & Northwestern Division were paid, or the exact fund out of which the interest upon the bonds of the other divisions was paid." (R. p. 680.)

As to the erection of betterments on the mortgaged premises, the findings are of the same inconclusive nature. The master nowhere finds that any improvements were erected and paid out of the income of the road. He finds on this subject as follows:

"I find that Alfred Abeel, receiver in this cause, has expended under the order of this court, $46,505.40 for betterments and permanent improvements from Decem-

ber 10th, 1892, to September 3rd, 1895, consisting of bridges, shops and round house, car shed, water stations, locomotives, chair car and fencing."

"I find that no part of the income arising from the operation of the road and no part of the proceeds of sales of old iron, old rails, old cars and engines, which was received by the receivers in causes Nos. 185 and 198, ever came into the possession of the receiver in this cause, and the evidence fails to show that any part of the new equipment purchased by the receivers in causes Nos. 185 and 198, as shown above, ever came into the possession of the receivers in this cause. The evidence fails to show that any improvements and betterments of the property added to the property of the Houston & Texas Central Railway Company by the receivers in causes Nos 185 and 198, were made on the Waco & Northwestern division." (R. pp. 663 to 664.)

It will be observed that he does not find that these betterments were paid for out of the revenue of the road. The record shows that the mortgage covered a large landed property, aggregating 223,622.28 acres of land, besides vendor's lien notes aggregating $107,145.66, still on hand, and which has during all this time been in the hands of the receiver. (R. pp. 391 to 441.) For ought that appears, the small amount of improvements erected by Abeel, the present receiver, were made out of funds arising from the sale of lands, or collection of land notes covered by the mortgage. In such case no diversion could exist. At least the burden was on petitioners, not only to allege but to prove a diversion. The Circuit Court of Appeals of the sixth circuit, in the case of Central Trust Co. vs. East Tenn. V. & G. Ry. Co., 80

Fed. at page 626, disposes of a claim that there had been a diversion upon a record substantially similar to the record in this case, and say:

"But it is also shown that, during the same period, money was borrowed on open account, more than sufficient to equal the diversion complained of, which went into a common treasury, from which operating expenses, preferential claims, interest, and improvements were paid, without any definite showing as to whether the borrowed money was applied to the payment of interest and improvements, or to current income debts. Under this system of bookkeeping, the addition of borrowed money to the income arising from operation showed a substantial surplus after payment of the great mass of income debts, and all disbursements on account of interest upon the two mortgages foreclosed, as well as upon improvements in the roadway. Prior to the period covered by the maturity of appellant's claims, there was a surplus of gross earnings over all operating expenses; but it cannot be contended that the company was under any obligation to future creditors to accumulate a surplus to meet possible deficiencies in the income to meet future income debts, or that it was improper to apply such surplus in payment of interest. St Louis A. & T. H. R. Co. vs. Cleveland C. C. & I. Ry. Co., 125 U. S. 658–675, 8 Sup. Ct. 1011. Whatever diversion there may have been of income to payment of debts or liabilities, not properly debts of the income, seems to have been more than reimbursed by the money borrowed. *The burden is upon complainants to show that there has been a misappropriation of earnings to the improvement of the mortgaged property, or to the payment of interest, before the mortgagees can be justly called*

upon to reimburse the fund applicable to debts of the income in consequence of such diversion. If interest was paid or improvements made out of borrowed money, then there was no diversion; or if made out of gross earnings, and the latter was reimbursed by borrowed money, the diversion was made good. The abstracts showing income from all sources and disbursements upon all accounts are somewhat complicated, in consequence of the mode of bookkeeping adopted. The commissioner and court below concurred in reporting that there was no diversion shown. In the absence of very cogent evidence of mistake of fact, or of some error of the law, the finding of fact by the commissioner must be accepted as final. Emil Kiewert Co. vs Juneau, 24 C. C. A. 294, 78 Fed. 708; Kimberly vs. Arms, 129 U. S. 512–524, 9 Sup. Ct. 355; Tilghman vs. Proctor, 125 U. S. 136, 8 Sup. Ct. 894; Turley vs. Turley, 85 Tenn., 256, 1 S. W. 891."

On what has been said, we are content to leave the case in the hands of this court on the question of diversion.

This brings us to the last inquiry; that is, whether petitioners have shown that they are entitled to have the decree appealed from reversed and the case sent back so that they may demand pro rata division of the income in the hands of the receiver among all the creditors? This proposition is based on the claim that the mortgage bonds are not secured by a lien on the income after possession was taken. The Circuit Court of Appeals of the 5th circuit, on the same day the opinion was delivered in this case, held, in the case of Geo. E. Downs vs. Farmers' Loan & Trust Company, et al, that the mortgage in this case did cover the income. (79 Fed. Rep at page 221.)

And petitioners claim is based upon the further contention that no one had a lien on the $91.371.00 interest paid to the bondholders, and proceeding from that assumption, it is demanded that this money should have been paid on the Lackawanna claim, at least its pro rata.

There is no warrant for the assumption that no one had a lien on the fund that was used in paying interest on the bonds. For the purposes of this point it may be conceded that the interest was paid out of current income as claimed by petitioners. The findings of the master show that on February 16th, 1885, the Southern Development Company filed its original bill of complaint against the Houston & Texas Central Railway Company in cause No. 185, and that upon this bill receivers, Clark and Dillingham, were appointed. That on March 31st, 1885, the Farmers' Loan & Trust Company filed its petition in said cause No. 185, praying to be made a party thereto, averring, among other things, that it was trustee under several separate mortgages executed by defendant railway company, and naming among them the mortgage declared herein. That the prayer of said petition was granted, and on April 6th, 1885, said court entered an order in said cause No. 185, allowing the Farmers' Loan & Trust Company to become a defendant in said suit; and further ordering that it may demur, plead or answer therein on or before the rule day in June, 1885. (R. pp. 671-2.) The record shows that demurrers were filed to the bill of complaint of the Southern Development Company by Easton & Rentool, trustees in one or more of the mortgages executed by defendant railway company, and on May 26th, 1886, these demurrers were in all things sustained, and the entire bill and the supplemental bill of the Southern Develop-

ment Company was dismissed. Upon the dismissal of these bills in cause No. 185, all the property was transferred to receivers in consolidated cause 198. That no other action was thereafter taken in cause 185, but causes 198, 199 and 201 were consolidated, and proceeded to judgment and foreclosure as consolidated cause 198. This consolidation of these causes took place on May 26th, 1886, and the three causes were filed a few months prior to this. (R. p. 672.) The bills in causes 198, 199 and 201 were bills to foreclose three mortgages given by the Houston & Texas Central Railway Company on its railway and properties. One was on the main line, the other on the Austin branch, and the third was a general mortgage on the whole system.

Neither the bills of complaint or the mortgages declared on in causes 198, 199 and 201 are in the record, and for that reason it cannot be determined whether these mortgages, in terms, covered the income after possession was taken. But it is clear that at the suit of the trustees in the mortgages declared on in causes 198, 199 and 201, all the property, income, rents and profits of the Houston & Texas Central Railway was, on May 26th, 1886, placed in the hands of receivers. By placing the property in the hands of receivers the complainants in those bills made an equitable levy upon the rents and profits to accrue from the operation of the road by the receivers. (Sage vs. Memphis etc. R'y Co., 125 U. S., 365.) And it is very likely that the mortgages were drawn in the usual manner of such mortgages, giving a lien on the income after possession is taken. As petitioners failed to bring up with the record these mortgages, it may be assumed that if here they would be of no value to them. It, therefore, appears with rea-

sonable certainty, that there was a lien on the income of the road and the whole system, after possession was taken at the suit of complainants in causes 198, 199 and 201 on May 26th, 1886, and continuously thereafter, and this lien was in favor of the mortgaged bondholders, secured by the mortgages declared on in the above three causes.

The interest payment of $91,371.00 to the bondholders secured by mortgage on the Waco & Northwestern branch so much complained of, was not made until May 1st, 1887, nearly a year after the receivers appointed in consolidated cause 198 had taken possession. This fact is perfectly manifest from the record. Under these conditions, and while the whole net revenue of the road was under lien to secure the mortgages declared on causes 198, 199 and 201, the complainants in those causes jointly with the trustee in the first mortgage on the Waco & Northwestern branch, applied to the court to have the coupons which matured on January 1st and July 1st, 1885, paid on all the bonds. The prayer of this petition was granted, and the interest was paid on all the first mortgage bonds, and the interest paid to these bondholders amounted to $91,371.00. As it appears petitioners' claim is not of the preferred class, and as it further appears that the use of the current income for the payment of interest was with the express consent and at the request of the bondholders holding a lien on the very fund used, and who alone could complain, there was certainly no "diversion" of which petitioners could complain. That is patent.

Let us view the matter from another standpoint. Suppose this $91,371.00 was to-day returned to the receivers in consolidated cause 198, and petitioners should apply to have it divided on the principle that equality is equity, and

demand a *pro rata* distribution? Would its petition be granted? No. Why?

Because they would be shown that the fund was net income which arose by operation of the road by the receivers appointed in consolidated cause 198, and that the bondholders either held a lien on this income by the terms of their mortgages after possession was taken, or by virtue of the equitable levy through the appointment of the receivers, and the whole fund would go the bondholders in those mortgages, and petitioners, after the labor and pains of much hard sailing, would be found stranded upon a barren shore, penniless and forelorn. If the bondholders, secured by mortgages declared on in cause 198, chose to allow and invite the bondholders in this cause to participate in a fund to which they had no legal or equitable right, and which belonged to the bondholders in cause 198, that was a matter which could not concern petitioners. Petitioners were not thereby deprived of a right of any description. They were not thereby made to lose a dollar. Not one dollar of the money that was paid to the Waco & Northwestern bondholders could have been recovered by petitioners, if the interest had not been paid. In a free fight, under the most favorable conditions, the able counsel for petitioners could not hope to successfully engineer this scheme of ratable distribution. It is a bare, naked falacy. It is a delusion. This court will not send this case back to the court below to enable counsel to chase a phantom.

We beg to call attention to the fact that this claim for *pro rata* distribution is an afterthought and a makeshift. No mention of such a claim can be found in petitioners' petition of intervention. (R. pp. 616 to 634.) The claim was prosecuted in the lower court upon the demand that

petitioners were entitled to priority over the bondholders. The contest was with the bondholders alone. No other party but these two could have an interest in that controversy. But in the doctrine of general equitable distribution now urged, all the creditors must be brought in and a general adjustment take place. This idea was the first time advanced in the Circuit Court of Appeals on page 24 of petitioners' brief in that court. It had not been, prior to that time, a matter of any concern to petitioners whether the bondholders had a lien or not. They claimed a lien prior and paramount to the best and highest. There is no assignment of error based upon this idea. It is a new tack, based upon the fertile imagination of the able and ingenious counsel who made it, but has no substantial foundation in any issue in this case.

But suppose it be conceded that the fund used to pay the $91,371 00 interest was not net income, and that nobody had a lien upon or charge against it. This concession aids petitioners not in the least. In the first place there is neither pleading or parties before the court to warrant the relief demanded. But the fatal answer to petitioner's scheme for equitable distribution, by requiring the bondholders to refund the $91,371.00, and take their share ratably, is that it is nowhere shown that upon the division proposed the bondholders would be entitled to less than they have already gotton. The record shows that the principal of the indebtedness due to these bondholders is over a million dollars. That the bonds bear interest at 7 per cent. per annum. That the only money paid them during a period of over 12 years, from July 1st, 1884, to this date, is the pittance of $91,371.00, and it is solemnly and earnestly demanded that they be required to return that,

so that petitioners may go back to the lower court and get together all the creditors, find out what each has received on his claim, and have a general division, and this, too, some ten years after the final decree of foreclosure has been entered in consolidated cause 198; the property all sold, and the proceeds distributed to thousands of creditors who are scattered to the four winds of heaven.

But this is not all. If for a moment it were conceded that petitioners ever had the remotest interest in the $91,371.00 paid on the bonds secured by the mortgage foreclosed herein, and had an apparent right to complain of this payment, we beg to call attention to the manner in which the holders of these bonds were treated by the receiver in causes Nos. 185, 198 and 227, until Alfred Abeel was appointed receiver to succeed Mr. Dillingham in December, 1892. This subject is treated fully in our main brief filed in the Circuit Court of Appeals, (a copy of which is filed herewith) under our fifth proposition, page . . . . . Summarized the treatment was this: During the time the entire system of the Houston & Texas Central Railway, which included the Waco branch, was in the hands of receivers from February, 1885, to December, 1892, there was spent in betterments and permanent improvements by the receivers $763,404.03. Not a dollar of this was put on the Waco branch. That branch is about one ninth in mileage of the entire system, and was justly entitled to one ninth of the betterments, which would be $84,822.67. It not only received no betterments by the receivers, but the old rail taken up by the company from that branch was on hand when the receivers were appointed, and was by them sold for $38,480.00 net. The mortgage, without doubt, covered these rails. The

Waco branch is therefore entitled to an equity equal to these two amounts, or the sum of $123,302.67 in the proposed pro rata distribution. These equities are superior to the claim of any unsecured general creditor like petitioners. This amount must, therefore, be deducted from the imaginary general fund proposed by petitioners and placed to the credit of the Waco branch, and it is only the balance left after this deduction is made that will be subject to the demanded equitable pro rata distribution. This amount would be more than sufficient to pay for all the rails laid down on the Waco branch out of the Lackawanna purchases, as the principal of the sum demanded against that branch is only $105,547.15, as this amount does not bear interest. (Thomas vs. Car Co., 149 U. S. 95.)

From this showing, we may reasonably conclude that if the demand of petitioners was granted and the case sent back for pro rata distribution, it would avail them nothing. But no question of "peculiar gravity" or "general importance" is raised in the failure of the Circuit Court of Appeals to pass on and consider this claim for equitable pro rata distribution.

If that was a grave and important question, petitioners surely would have raised the point in the Circuit Court. It is a little strange that a right which is so grave and important as to form the subject of a petition for *certiorari* would have been wholly neglected in the prosecution of this case for a period of over 12 years, and was never raised until the idea was incorporated in the brief of petitioners filed in the Circuit Court of Appeals. (See brief, page 24.)

It will be borne in mind, further, that no ground is assigned as a reason why this court should grant the writ and review the action of the Circuit Court of Appeals in failing to pass on the question under discussion. It is nowhere claimed that a question of peculiar gravity, general importance or conflict of decision is involved in that question.

We have now gone over all the grounds insisted on in the petition. We have not seen the brief filed by petitioners' counsel in support of the petition, but we are lead to believe from what we see in the petition that no new point has been raised.

We are advised by the petition that the briefs filed by petitioners in the Circuit Court of Appeals have been filed in this court. We likewise file herewith copies of our briefs filed in the Circuit Court of Appeals as follows: "Brief for Appellees, Moran Bros. and Henry K. McHarg," which presents the merits of the defense. "Supplemental Brief of Moran Bros. and Henry K. McHarg" which is devoted mainly to correcting errors found in the brief of petitioners, filed in that court. "Brief of Moran Bros. and Henry K. McHarg, Appellees, in Opposition to Motion for Rehearing," which is a reply to the first brief filed by petitioners in support of their motion for rehearing, and an "Additional and Supplemental Brief in Opposition to Rehearing," which is a reply to the last brief filed by petitioners for rehearing. We feel that in view of the fact that petitioners have filed their briefs, we should file ours in reply. And we submit with confidence

that petitioners have shown no reason why this court should grant a writ of *certiorari*, and respectfully ask that the prayer of the petition be denied.

Respectfully submitted,

L. W. CAMPBELL,

Solicitor for Moran Bros. and Henry K. McHarg, Intervening bond holders.

C. A. 5th No. 22.

First Opp.t to Br. of Campbell for Respondents.

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Filed Oct. 11, 1897.

UNITED STATES CIRCUIT COURT OF APPEALS,

FIFTH CIRCUIT.

LACKAWANNA IRON AND COAL COMPANY,
APPELLANT,

vs.

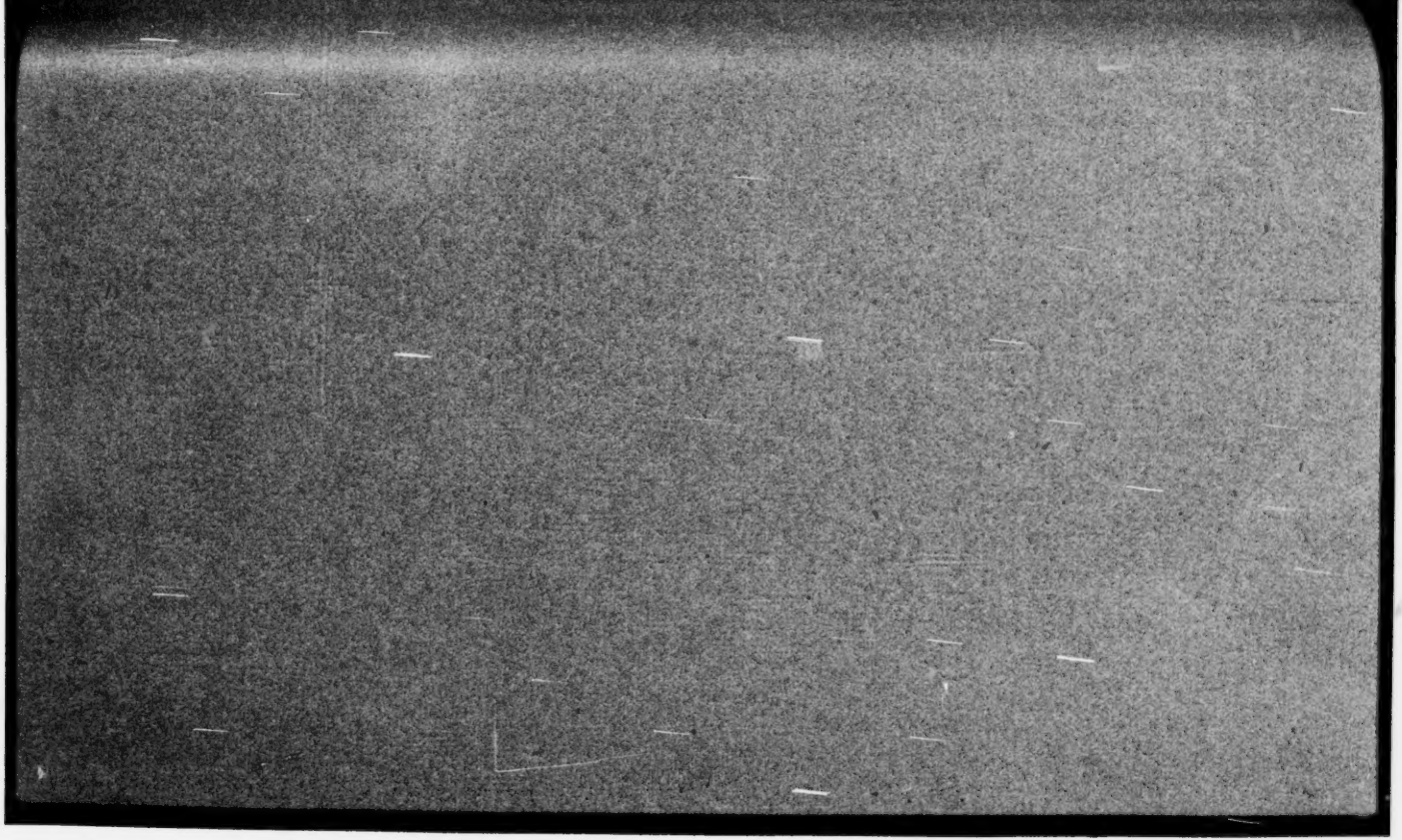
FARMERS' LOAN AND TRUST COMPANY, ET AL.,
APPELLEES.

BRIEF FOR APPELLEES MORAN BROS. AND HENRY K. McHARG.

(Reprint, omitting immaterial portions.)

L. W. CAMPBELL,
Solicitor for Moran Bros. and Henry K. McHarg, Appellees.

BYRNE-HILL PRINTING HOUSE, PRINTERS, WACO.



No. 503.

UNITED STATES CIRCUIT COURT OF APPEALS,

FIFTH CIRCUIT.

LACKAWANNA IRON AND COAL COMPANY,
APPELLANT,

VS.

FARMERS' LOAN AND TRUST COMPANY, ET AL.,
APPELLEES.

BRIEF FOR APPELLEES MORAN BROS. AND HENRY K. McHARG.

(Reprint, omitting immaterial portions.)

The subject of appellant's intervention is the sale and delivery by the Lackawanna Iron and Coal Company to the Houston and Texas Central Railway Company, prior to the appointment of a receiver over the property of said company, and during the years 1882 and 1883, of 18,581 tons of steel rail at an aggregate cost of $735,454.30.

The object sought by intervenor in this proceeding is to obtain priority in the payment of its claim over the mortgage bond holders out of the proceeds of the sale of the property, or the net income arising from the operation of the road. The claim was referred to a special master who was ordered to hear evidence and report the facts to the Court. The complainant and these appellees appeared before the master and after pleading the general issue specially pleaded that the claim was stale and barred by laches and barred by the Texas Statute of four years limitation. The master in due time filed his report, which was not excepted to and is copied in full in the record. Upon the hearing a decree was entered dismissing the petition.

First Proposition.

Before a debt contracted by the Railway Company prior to the appointment of a receiver will be given priority over the debt of the bond holders secured by a prior mortgage on the road, it must appear in cases where the debt is for supplies or material, (1) that it is the purchase price of current supplies needed from time to time to keep the road in repair, (2) bought on temporary credit, which credit resulted from the nature and character of railroad business, (3) that such purchase was made within a reasonable time prior to the appointment of a receiver of the property.

STATEMENT.

1. On this subject the master finds: "I find that the debt for which the Lackawanna Company claims payment in its petition, *cannot be classed as a current debt*, made in the ordinary course of business; * * * that the credit

extended under said contracts was at the request of and for the accommodation of the defendant Railway Company, and *upon its general credit*, * * * without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund or in any particular way; that said sale was for *an unusually large amount of rails*, and defendant was unable to pay cash therefor." (R. p. 656.) The magnitude of these dealings become apparent upon an examination of the master's findings. In the period of about fourteen months defendant bought of petitioner 18,581 tons of rail, at an aggregate cost of $735,454.30, which at 88 and 84.86 tons per mile for 56 and 54-pound rails respectively, were sufficient to reconstruct 214.77 miles of track.

2. The master further finds: "I find that negotiable promissory notes were given petitioner by the defendant company for all rail sold under the three contracts; *that all of said sales were made on a stated credit for a fixed period of time*, viz: six months after the average date of each delivery, and that said *defendant company had the right, under said contracts, to extend the time six months longer from the maturity of said notes;* that such extensions were made for the accommodation and *to suit the convenience of said defendant company and* that said extended negotiable *notes remaining unpaid matured* as shown above in clauses 2 and 3, *during the months of February, March, April and May, 1885.*" (R. pp. 754-5:) The above finding shows that the credit was voluntarily extended, and did not result from the nature of the business or necessities of the case.

3. The sales were not made within a reasonable time

prior to the appointment of a receiver over the property. On this subject the master finds:

"I find that all the rails delivered under the first contract, and about one half of the rails delivered under the second contract were paid for by the Railway Company prior to the appointment of any receiver of said property, but that the remaining half under the second contract, and all rails furnished under the third contract, are not paid for.

"I find that the rails furnished under the *second contract* were furnished under a contract made *a year and ten months prior to* the appointment of the receiver in cause No. 185, and about *three years and three months prior to* the appointment of a receiver in Consolidated Cause No. 198, and about *six years prior to* the appointment of the receiver in *this cause.*

"I find that the rails furnished under the *third contract* were furnished under a contract made about *sixteen months prior to* the receivership in cause No. 185, and about *two years and nine months prior to* the receivership in Consolidated Cause No. 198, and about *five years and six months prior to* the appointment of a receiver in *this cause.*" (R. p. 655.)

AUTHORITIES:

1. Must be for indebtedness for current supplies, labor, etc.

Bound vs. Ry. Co., 58 Fed. Rep., 473.
Thomas vs. Car Co., 149 U. S., 95.
H ale vs. Frost, 99 U. S., 389.
Blair vs. Ry. Co., 22 Fed. Rep., 471.
Huidkoper vs. Locomotive Works, 99 U. S., 258 and 260.

2. Credit must be temporary and result from the necessities of the business.

Blair vs. Ry. Co., 22 Fed. Rep., 471.

3. Debt must have been contracted short while prior to appointment of receiver.

Thomas vs. Peoria Ry. Co., 36 Fed. Rep., 808.
Turner vs. Indianapolis Ry. Co., 8 Biss, (U. S.) 315.
Fosdick vs. Scholl, 99 U. S., 235.
Union Trust Co., vs. Ill. Mid. Ry. Co., 117 U. S., 434.
Taylor vs. Ry. Co., 7 Fed., 377.
Miltenberger vs. Logansport R. Co., 106 U. S., 286.

Six months seems to be the general rule, which may be deduced from the authorities, and it is only in cases presenting strong equitable features that back debts of longer standing will be given priority. No exceptional equity seems to be claimed in this case, or if claimed none is shown. In this case the last contract was made sixteen months prior to the first receivership and five years and six months prior to appointment of receiver in this cause.

Second Proposition.

The effect and the only effect of a finding that a back debt was contracted an unreasonable time prior to the appointment of a receiver is to take the claim out of the preferred column and place it among the general floating indebtedness of the company, and when this is done by a direct finding that the debt was contracted upon the general credit of the company, it is not material whether it was contracted a reasonable or unreasonable time prior to the appointment of a receiver.

STATEMENT.

The master finds that petitioner's claim is *not a current debt*, and was contracted on the *general credit* of the company. (R. p. 656.)

Thomas vs. Peoria Ry. Co., 36 Fed., 808.

Manchester Locomotive Works vs. Truesdale, 44 Minn., 115.

Third Proposition.

Before such debt will be given priority it must appear that the material was not sold on the general credit of the company.

STATEMENT.

On this subject the master finds as follows: "I find that when the aforesaid contracts were made with the said Lackawana Company both seller and buyer expected the debts to be paid from the net income of the railway; that the credit extended under said contracts was at the request of and for the accommodation of the defendant Railway Company, *and upon its general credit.* That sales were made *without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund, or in any particular way;* that said sales were for *an unusually large amount of rails;* and the defendant was unable to pay cash therefor, and there was no way of obtaining said rails except upon credit; and *petitioner* herein at the time of said contracts and sales *had knowledge of the mortgage of June* 16, 1873, given by the defendant Railway Company upon the properties of the Waco and Northwestern division to secure the first

mortgage bonds, which said mortgage has been herein foreclosed." (R. p. 656.)

The foregoing findings establish that the rails furnished were *upon the general credit of the company*, and that said purchase was for an unusually large amount of rails, and petitioner at the time of said sales had knowledge of the mortgages declared on herein. Such being the case, under no circumstances could petitioner be given priority over the bond holders.

The purchases under the three contracts set up in intervenor's petition are for 20,000 tons and under these contracts in less than fourteen months 18,581 tons were delivered at an aggregate cost of $735,454.30, being enough rail to lay down a new track outright 214.77 miles. After paying nearly one-half the amount due on these purchases there remains unpaid over $550,000.00, with interest for six or seven years, making an aggregate amount unpaid on said contracts of about $850,000.00. From the findings of the master and the facts supporting said findings, it is apparent that this claim belongs to claims known as "claims for material furnished for general and original construction" or for "general merchandise," and where this is the case, the claim under no circumstances is entitled to priority over the mortgage bond holders, either to the proceeds of sale, or net revenue arising from the operation of the road, and it is immaterial under such circumstances whether there has been or not interest paid on the bonded indebtedness, or the erection of permanent improvements on the property.

Thomas vs. Car Co.. 149 U. S., 95.
Bound vs. Ry. Co., 58 Fed., 473.

Fourth Proposition.

Before a debt for current supplies will be given priority it must appear that the order appointing the receiver made provision for the payment of such claims and that there has been a wrongful diversion of the current revenues of the road which should or would have been used in the payment of such debt to the payment of bonded interest or permanent improvement of the property covered by the mortgage, and the extent of such priority will be limited to the amount diverted. Neither fact exists in this case.

STATEMENT.

1. There is no provision in any of the orders appointing receivers in causes 185, 198 and 227 for the payment of back debts.

2. There has been no diversion of the income of the road to the payment of bonded indebtedness or permanent improvements which should or would have been used for the payment of petitioner's debt either by the railway company prior to receivership of said property or by any of the receivers since. All interest appears to have been paid on bonded indebtedness up to January 1, 1885, when the first default occurred. No interest has been since paid on first mortgage bonds of the Waco division, except $91,371.00 paid by order of the Court by the receivers in cause 198 on or about May 1, 1887, being the installments of interest which matured January 1 and July 1, 1885, and interest thereon to date of payment. (R. p. 670.) This is all the interest that has been received by those bond holders for a period of twelve years. The rail in question was sold un-

der two separate contracts; one dated April 26, 1883, under which 5,009 tons of 56-pound rail at $39.50 per ton were delivered during the months of June, August and September, 1883. (R. p. 651.) The other contract is dated October 30, 1883, under which 8,552 tons of 54-pound rail at $36.60 were delivered during February, March, April and May, 1884. (R. p. 653.) The contracts of sale provide that the rail is to be paid for in notes at six months with six per cent. interest, with privilege in the Railway Company to extend time of payment six months longer. In accordance with the terms of these contracts, notes were given and which were renewed and extended from time to time, so that all the notes due petitioner matured after January 1, 1885, and during the months of February, March, April and May. (R pp 651 to 653.) Petitioner having extended the time of payment could not in the meantime prior to the maturity of the notes demand payment of said notes, and cannot now complain of interest payments being made before the maturity of its own notes. The record shows that the bonded interest of the railway company was payable semi-annually on January 1 and July 1. Interest was paid January 1, 1883, July 1, 1883, January 1, 1884, and July 1, 1884, by the company. All these payments were long prior to the maturity of petitioner's debt. It can in no sense be said that these interest payments was a diversion of the stream from its natural channel. It cannot be presumed that this would have been paid to petitioner but for the interest payment, for at that time the company owed petitioner no matured debt. Petitioner is therfore estopped by its own contract in first giving time and afterwards extending time of payment from claiming the money used in paying interest on the bonded debts from the date of the sale in 1883 to

maturity of its debts in February, March, April and May, 1885.

Our position is that petitioner cannot complain of the payment of any valid debt of the company which was in existence when the rail was sold, and of which it had notice, and which matured prior to the maturity of petitioner's debt. This would give all interest installments which matured prior to February, March, April and May, 1885, priority over the debt of petitioner, and of course would include the installment of interest which matured January 1, 1885.

The receivers in cause 185 were appointed February 20, 1885, and the property has been in the possession of receivers in causes 185, 198 and 227 continuously since. As stated above no interest was paid in causes 185 or 227, and of the payments made May 1, 1887, one-half was for interest which matured January 1, 1885, and which matured prior to the maturity of any of petitioner's notes, and which petitioner must have understood would be paid at maturity. The whole of said interest payment of May 1, 1887, was made on application to the Court in cause 198, to which cause petitioner was a party. If petitioner was in law or in fact entitled to said fund in preference to the bond holders, in that cause, and on that occasion, was the time and place to have asserted its right thereto. Besides the order was made without prejudice. On this subject the master finds:

"I find that said order expressly declared that it was 'without predjudice to the rights of defendant or of any intervenor in this cause, or any final decree to be rendered in the same, nothing herein being decided as to the merits of the claim of the defendants, or of intervenors, and this or-

der not in any manner stopping or affecting the rights of any party or intervenor in this cause.'" (R. p. 674.)

If this money was received by the bond holders without prejudice they are surely not to be harrassed in after years in a separate suit with a serious charge that this interest was wrongfully taken from one of the very creditors who was a party to the cause and participated in taking the order. The bonds and mortgage securing same are admitted to be valid and unpaid, and if the bond holder is not protected by the above provision against the charge of diversion in accepting this interest, then it may be truly said that this money was taken with great probability that the act of doing so would be very prejudicial, indeed, to the extent of refunding every dollar received with interest thereon at the end of an expensive lawsuit. The order was doubtless intended to provide for the payment of a debt which was conceded to be valid, but that in doing so no precedent should be established as to who was entitled to priority in payment out of the net income or proceeds of sale of the road as a protection to petitioner and other parties and intervenors who were asserting priority over the bond holders, and that the bondholder, on the other hand, in accepting the money, should not be charged with diverting that money from the other claimings.

If the above is a valid interpretation of the order it is manifest that no diversion has been shown by way of interest payment. It only remains to be considered whether there has been a wrongful diversion of funds in the erection of betterments and permanent improvements on the Waco branch. On this subject the master finds:

"I find that no interest has been paid on the bonded in-

debtedness by either of the receivers in this cause; I find that Alfred Abeel, receiver in this cause, has expended, under the orders of this court, $46,505.40, for betterments and permanent improvements, from December 10, 1892, to September 3, 1895, consisting of bridges, shops and roundhouses, car shed, water stations, locomotives, chair car and fencing." (R. p. 663)

"I find that no part of the income arising from the operation of the road and no part of the proceeds of sales of old rails, old iron, old cars and engines, which was received by the receivers in causes Nos. 185 and 198, ever came into the possession of the receiver in this cause, and the evidence fails to show that any part of the new equipment purchased by the receivers in causes Nos. 185 and 198, as shown above, ever came into the possession of the receivers in this cause. The evidence fails to show that any improvements and betterments of the property added to the property of the Houston and Texas Central Railway Company by the receivers in causes Nos. 185 and 198, were made on the Waco and Northwestern division." (R. p. 664.)

"I find that prior to April 6, 1889, no separate accounts were kept of the receipts and disbursements of the Waco and Northwestern division, but the same was operated as a branch of the general system of the Houston and Texas Central Railway Company, and the evidence fails to show what, if any, of the expenditures made by the receivers in causes Nos. 185 and 198 for extraordinary repairs, betterments and improvements and for operating and running expenses were made for said Waco and Northwestern division, and what portion for the other division of said Houston and Texas Central Railway Company; and this is true also as to receipts and incomes." (R. p. 664.)

"I find that the receivers in cause No. 185, had on hand in cash at the opening of business on January 21, 1886, $175,393 65, but there is no evidence that any part of said fund came into possession of the receivers in this cause." (R. p. 664.)

"I find that the receiver in cause No. 198, had on hand at beginning of business on April 6, 1889, cash amounting to $215,842.45, but the evidence does not show that any part of said funds came into the hands of the receivers in this cause." (R. p. 664.)

The above findings show that the only betterments added to the Waco branch in the long period of time covering over eleven years, was $46,505.40 for betterments and permanent improvements from December 10, 1892, to September 3, 1893, consisting of bridges, shops, and roundhouses and car sheds, water stations, locomotives, chair car and fencing. The first expenditures for these betterments (December 10, 1892) were made nearly eight years after maturity of petitioner's notes and the last (September, 1895,) were made over ten and a half years thereafter. At this time, unless suit had been instituted on the notes they would have been long since barred by limitation, and it could not be held that this fund arising from the operation of the road a decade after the rail were furnished was the current revenue which should have been applied to the payment of petitioner's debt. If this were so there would be no current fund available for the payment of current expenses and the necessary improvements from time to time required to keep the road "a going concern." No Court has ever held that expenditures, so far removed by time, place and circumstance from the claimed current indebtedness to

amount to a diversion. But, aside from this, these expenditures were all made under the orders of this Court, in this cause, to which petitioner has been a party since 1891. The right to order such expenditures and the necessity therefor has been long since determined by this Court, and such orders estop and conclude petitioner.

Bound vs. Ry. Co., 58 Fed., 473.
Central Trust Co. vs. Chattanooga Ry. Co., 69 Fed., 295.
Cutting vs. Ry. Co.; 61 Fed., 150.

The foregoing argument is based on the assumption that it was found by the master that the interest payment of $91,371.00, in May, 1887, on the Waco & Northwestern division bonds, was made *out of the current revenues of the road.* On this subject the master finds that the accounts were not kept in such a manner as to indicate the exact fund out of which the interest payments were made, and that no separate account was kept of the earnings of the Waco & Northwestern division as distinguished from the earnings of the other division. And he nowhere finds that this interest was paid out of the income. (See his findings R. pp. 664, 670 and 680.) The same is true as to the expenditures for betterments and new equipment. The master finds that the only expenditures made for that purpose on the Waco & Northwestern division was made by receiver Abeel after December 10, 1892, and prior to September 3, 1895, and amounted to $46,505.40. (R. pp. 663-4.) But there is no finding that these expenditures were made *out of the current income.* The finding is simply that this amount of money was used for that purpose. The burden was on appellant to prove that the expenditures, which it is claimed amounted to a diversion of the current income, were, in

fact, made from *that* fund. The findings leave appellant's case without equitable support. For the only real equity relied on by appellant to establish the claimed priority, was the alleged diversion of current income from the payment of supply creditors to the payment of interest on the bonded indebtedness and the erection of permanent improvements upon the mortgaged property.

Appellant would not be entitled to recover on the ground that it furnished the rail that went into the road, because this rail was sold on the "general credit of the company," was no part of the "current supplies," was part of an "unusually large purchase" without any understanding that the rail "should be paid for in any particular way or out of any particular fund." Besides, the findings show that the rail was furnished twelve to thirteen years ago, and there is nothing in the record to show to what extent, if any, the rail enhanced the value of the mortgage security, or that the road has earned a greater net revenue or sold for a greater price as a result of the placing of this rail in the road. There are no findings whatever on these issues. Appellant is in no position to complain of the sudden action of the court in appointing receivers in cause 185 in February, 1885, for in a short while thereafter appellant intervened in said suit, joined the Southern Development Company in its prayer for a receiver, and in all things ratified the acts of that company. R. p. 661.

Cutting vs. R'y Co., 61 Fed., 150.
Central Trust Co. vs. R'y Co., 69 Fed., 295.

Case of Bound vs. Ry. Co., 58th Fed., 473, is in point. In that case this same company, the Lackawanna Iron and Coal Company, intervened on precisely the same character of

claim as asserted here for the price of steel rails sold to the Railroad Company on a credit of eight months, and the sale was made eighteen months prior to the appointment of the receiver, and said rails were necessary to the maintenance of the road, and were sold on the promise of the president of the road that they were to be paid for out of the earnings, but this promise was not fulfilled. The notes were extended from time to time, and during the interval before the maturity of the first note $33,000.00 was paid on account of interest due the mortgage bond holders. It was claimed by intervenor there, as is claimed here, that because its debt was for material which went into the road, improving its condition, and because there had been a diversion of the current debt fund to the payment of interest on mortgage bonds, it was entitled to displace the bond holders to the extent of such interest payment. The claimant prevailed in the lower Court, and the displaced bond holders appealed to the Circuit Court of Appeals. Chief Justice Fuller, acting as Circuit Justice, and Judges Hughes and Morris composed the Court, and in passing on and deciding the claim of intervenor there asserted, the Court say: "The rule giving preference to current expenses incurred on the faith of the earnings of a railroad shortly before the appointment of a receiver has never been carried so far. The debt of the Lackawana Company was an ordinary merchandise debt. The road being heavily mortgaged all that any unsecured cred itor had to look to was the earnings. The immediate earnings, it is clear, the Lackawana Company did not look to, as the sale was on a credit of eight months. It must be inferred, therefore, that it was expected that interest on the mortgage debts was meanwhile to be paid during the running of the credit, otherwise a foreclosure would have been

imminent within three months after the sale of steel rails was made. The claim is quite different from those ordinary and necessary expenses of operating a railroad contracted but a short time before a receivership, and which by the sudden action of a Court in appointing a receiver, are left unpaid."

Fifth Proposition.

Though it may appear that petitioner's claim on some of the grounds asserted in whole or in part, is entitled to an equitable priority over the mortgage bond holders, such priority will not be decreed in this case, but petitioner will be remitted to its intervention in cause No. 198, because (1) it would be inequitable and unjust to charge the proceeds arising from the sale of road—made more than eleven years after the purchase of said supplies—and the net revenues arising from its operation from five to eleven years thereafter, with payment of such debt, and (2) it appears that the receivers in causes Nos. 185 and 198, from February 20, 1885, to April 6, 1889, a period of over four years, immediately after petitioner's debt matured, operated the whole H. & T. C. system, including the Waco branch, took all its revenues and profits during these four years, took 2,960 tons of old iron rail from the Waco branch and disposed of same at a net price of $13 00 per ton, aggregating $38,480.00, used the proceeds from the sale of this rail and the revenue of this branch for the purchase of new cars, locomotives and other equipments and the erection of betterments and permanent improvements of the main line and Austin branch, and (3) it appears that this branch during these four years received no betterments or permanent improvements, and the receivers in this cause re-

ceived no part of the new cars, locomotives and other new equipments purchased by the receivers in causes 185 and 198 and have never come into the possession of any of the revenues arising from the operation of said road during the years 1885 to 1889 or the proceeds from the sale of said old iron rail, and because the bond holders secured by the mortgage declared on herein asked no equitable relief in said causes, 185 and 198, and received no part of the proceeds of the sale of the road in said causes.

STATEMENT.

On the subject here discussed, see master's finding No. 16. (R. pp. 663 4.)

On the subject of receipts and expenditures of the entire system by the receivers in causes Nos. 185 and 198, the master finds as follows:

"I find that during the receivership of Clarke & Dillingham, in said cause No. 185, they received from the operation of the Railway company, revenues, and expended for operating expenses, taxes, etc., the following amounts, to-wit:

Amount received from Febuary 23, 1885, to January 21, 1886, two million, seven hundred and fifty-eight thousand, four hundred and eighty-seven and 40-100 dollars	2,758,487.40
Operating expenses, taxes, etc., same period ..	2,137,322.44
Balance or surplus	621,164.96
Amount received from January 21 to July 10, 1886, one million, one hundred and forty-three thousand, seven hundred and thirty-one and 05-100 dollars	1,143,731.05

For operating expenses, etc., for the same period	1,341,753.85
Leaving a deficit for this period of	$198,022.80
And leaving a net balance from the operation of said railways from February 23, 1885, to July 19, 1886, of	$423,142.16

XIX.

"I find that when said Clarke & Dillingnam took possession of the property of the defendant railway company on February 23, 1885, they received in cash $30,416.34.

That they collected assets of the company as follows, to-wit:

Traffic balances and other claims	118,730.08
Sales of old rails on hand February 23, 1885	110,275.00
Sale of old cars	6,500.00
Total	$265,921.42
Amount expended in paying liabilities of the defendant Railway Company	$23,274.20
Interest paid upon the first mortgage bonds of the company, being interest due January 1, 1885, to July 1, 1885	751,438.15
Amount expended for new steel rails	$245,793.64
Amount expended in payment of certain car trust notes	125,695.44
Amount expended for new passenger coaches, baggage, mail and express cars, etc., and locomotives	265,696.33

Amount expended by said receivers for right of way, fencing, track, real estate, depot, roundhouse, foundry and pattern house at Houston	126,218.62
Total	$1,536,116.38

"I find that the amount expended as above, $384,026.20, was expended under the receivership of Messrs. Clarke & Dillingham."

"The above statement shows receipts and expenditures to January 9, 1888, the date when Master Winter, heard the evidence on this intervention in cause No. 198, but no proof has been offered before me, showing the receipts and disbursements of the receivership in said consolidated cause since said hearing before said master on January 9, 1888."

XXI.

"I find that said Easton and Rintoul and Dillingham during their receivership realized out of proceeds of sale, or collection of old assets of the defendant company, the sum of $135,889.70."

XXII.

"I find that the receivers in cause No. 198 received from the receivers in cause No. 185, the sum of $138,751.37 in cash."

"I find that the receivers in consolidated cause No. 198, after they took possession of the assets of the Railway Company on July 10, 1886, and up to the time of the filing

of the report of master, Winter, paid liabilities of the receivers, Clarke & Dillingham, taxes, outstanding vouchers, pay rolls, traffic balances, $221,421.32, and collected from the amount due said Clarke & Dillingham as receivers in cause No. 185, $39,016.69."

The above statement shows that the receivers in cause No. 185 expended for betterments as follows:

Amount expended for new steel rails.....	$245,793.64
Amount expended in payment of certain car trust notes.....	135,695.44
Amount expended for new passenger coaches, baggage, mail and express cars and locomotives.....	265,693.33
Amount expended for right of way, fencing track, real estate, depot, roundhouse, foundry and pattern house at Houston....	126,218.03
Making a total of.....	$763,404.63

This entire amount, $763,404.03, was expended in making betterments and improvements, and the purchase of new equipments, etc., on the main line and Austin branch, and no benefit thereof has ever accrued to the Waco branch. The above amount was undoubtedly paid out of the current revenue of the road, and the Waco branch was entitled to its proportionate share. The findings show that no separate account was kept and in the absence thereof, the only equitable division would be on a mileage basis. The Waco branch is about one-ninth in length of the mileage of the entire system and would be equitably entitled to receive out

of the above fund $84,822.67 in betterments and permanent improvements when in fact it received none. In addition to the above statement the findings show that the receivers in cause No. 185 sold 2960 tons of old rail taken from the Waco branch, on which these bond holders had their mortgage, at $13.00 per ton, making an aggregate of $38,480.00. The findings show that no part of this fund has ever come into the hands of the receivers in this cause. This amount added to the above sum of $84,822.67 makes a total of $123,302 67, that has been wrongfully (as against these bond holders) taken from the Waco branch, and used in the erection of improvements upon the main line and Austin branch. The findings show that 6.2 miles of the Waco branch was laid with rails furnished under the first and second contracts, but no proof was introduced showing what proportion was furnished under each. The findings show that all rails furnished under the first and about one half furnished under the second contract were paid for by the Railway Company prior to any receivership over the property. Such being the findings, no amount has been shown to be unpaid to petitioner for the 6.2 miles. The findings show further that 30.8 miles af the Waco branch was laid with rails furnished under the third contract, being the 54-pound rail, and that it requires 84.86 tons of said rail to lay a mile of track, which makes 2,613.68 tons of rails on the 30.8 miles. The purchase price of this rail is $36.60 per ton, making a total of $94,560 68, the original cost price of the total rail unpaid for on the Waco branch. Deducting this amount from the $123,302 67 leaves an excess of $28,741 99 that has been wrongfully taken from the Waco branch and appropriated and used on the main line and Austin branch for permanent improvements and betterments, after fully pay-

ing for all steel rails unpaid for on the Waco branch. These figures show that a great wrong has already been committed to the extent of over $28,000.00 and if the fund now in Court should be used in the payment of the 30.8 miles of steel rail another and a greater wrong by far would be committed, but should the receivers in cause No. 198 be required to pay for these rails justice to that extent would be attained.

The foregoing makes it apparent that the petitioner should be remitted to its intervention now pending and undetermined in said cause No. 198. The lower Court still has jurisdiction over both causes, and entire control of these interventions.

These views were urged upon the attention of the trial Court and it may be that they had the desired influence in the termination of the case. There is no assignment of error covering this feature of the case.

Sixth Proposition.

Petitioner alleges as one of its grounds of priority that there is a provision in the mortgage declared on herein, allowing the trustee, in case it takes posession of the property under the terms of the mortgage, to pay the floating indebtedness of the company, and that it relied on said provision in selling the rails to the defendant Railway Company. But there is, in fact, no such provision in the mortgage.

STATEMENT.

On this subject the master finds as follows:

"I find in the mortgage given by the Houston and Texas

Central Railway Company to the Farmers' Loan and Trust Company, trustee, dated June 16, 1873, being the same mortgage declared on herein, the following provisions:

"'And in case the said Houston and Texas Central Railway Company shall fail to pay the principal, or any part thereof, or any installment of the interest, or any part thereof, on any of said bonds at any time when the same shall become due and payable according to the tenor thereof and for sixty days after having been demanded, it shall be competent for the said trustee, its successors or assigns, to enter upon the said railway and premises and property herein conveyed, by its attorneys and agents, and take possession of same without let or hindrance of the said first party and every part and parcel thereof, and the appurtenances, and appoint an agent to operate and manage the same, and receive the revenue and income thereof, applying the said funds, after deducting taxes, necessary expenses and counsel fees, to keep the same in good order and repair, and the surplus to pay the principal and interest of all the bonds which may be due and outstanding, and secured hereby, pro rata, and thereafter, to the payment of any contributions due to the sinking fund herein established. And upon the request of the holders of one-fifth in amount of the bonds so in default which may be at any time outstanding under this deed of trust, it shall be the duty of said second party by its president, or agent duly appointed in its behalf, to enter upon and take actual posession, with or without entry, or foreclosure of said railway and property herein described, and all and singular each and every part and parcel thereof, and assume its management until the arrears of both principal and interest be paid, or the prop-

erty sold, as herein drescribed, receiving the rents, revenue and income thereof and applying them in the same manner as above stated.

"'It is, however, expressly agreed that the said party of the first part may dispose of the current net revenues and income of all the said property and railway hereby conveyed in such a manner as it shall deem best, until default shall be made in the payment of the interest or principal of said bonds, or of any one or more of them, and shall have the right to sell and dispose of any of such real estate or other property as it may own or acquire, which may not be needed or acquired for the purposes and business of the said Waco and Northwestern division, except in the case of the six thousand acres per mile of completed road, and which sale and conveyance of such outside property shall transfer the said property and title free from encumbrance of this mortgage or deed of trust, and to change its tracks and make any and all alterations necessary for the benefit of the same.'

"I find that there is no provision in said mortgage, that the trustee may, if it acquires possession of said railway under said mortgage, pay any floating debt, or debts, of said company out of the gross earnings of said railway." (R. pp. 664 to 666.)

This suit was filed by the trustees for the mortgage bond holders in the mortgage declared on herein on April 6, 1889, and at the suit of said trustee this Court placed the railroad and other property covered by the mortgage in the hands of a receiver, complainant's bill setting up the above provision contained in the mortgage declared on, claiming a lien on the corpus of the property, and the earnings of the

road after the same was placed in the hands of the receiver. Petitioner did not intervene in this cause until more than two years after, and on to-wit: November 3, 1891, simply setting up its priority, and nothing more.

AUTHORITIES.

Dow vs. Memphis & Little Rock R. Co., 124 U. S., p. 652.

(S. C.) 33 Am. & Eng. R. R. Cases, p. 12.

Sage vs. Memphis & Little Rock R. Co., 125 U. S., 361.

(S. C.) 35 Am. & Eng. R. R. Cases, p. 40 and cases therein cited.

Argument.

The merits of appellant's claim for priority is made to rest solely upon the supposed existence of this clause in the mortgage. (R. p. 627.) From this allegation it plainly appears that appellant when selling these rail and in extending the time, it was fully recognized that no superior equity existed over the mortgage, or if any existed it was not relied on. Instead of selling these rail upon the belief that priority would be given upon principles of equity, appellant seems to have made the sales with full knowledge of the existence of the mortgage, and with the understanding that a contract had already been made for its benefit and perfect protection, in that the mortgage contained a clause which required appellant's debt to be paid in any event. This allegation not only shows upon what security appellant relied, but it shows, with equal clearness,, the *rank* and *character* of appellant's claim. It shows that appellant, in selling the rail and in placing reliance upon this clause understood its claim to be a mere "floating debt," for the supposed clause relied on provides, according to the allegation, for the pay-

ment of "floating debts" only. But this particular mortgage contained no such provision. The foundation having failed the superstructure cannot stand. The evidence shows that a number of mortgages given by defendant company were in existence at this time. It is probable that one or all the others contained some such stipulation. Be this as it may, by the allegation above we are given appellant's own version of the rank of its claim, and the security upon which the rail was sold. Having relied on that security no other can now be claimed in the present condition of the record. "The express mention of one thing implies the exclusion of another," is a legal maxim which controls the language of this pleading. We concede that this is not a rule amounting to estoppel. The petition could have been amended and a different set of facts alleged, and if true, been proven. But nothing of the kind has occurred. No amendment, no change. The case went before the master and trial court and is brought here claiming and asserting, in the strongest language, that the mortgages contain this clause and that appellant relied on the contract therein made for its benefit in selling the rail, has in all things accepted its terms and conditions, and bases its suit thereon. The allegation makes a case of a lien created by express contract for the benefit of "floating debts," with an unqualified acceptance by appellant. If he relied on this supposed express contract he did not rely on the equity asserted by the assignments of error. But the master finds "that both seller and buyer expected the debts to be paid from the *net* income of the railway." (R p. 656) This understanding that the claim was to be paid from the *net* income, as distinguished from the current or gross income, effectually took this claim out of the preferred column and placed it among the general floating indebted-

ness of the company. This, in connection with the further finding of the master, that the rail was sold on "the general credit of the company," that it "was not a current debt," and that the "purchase was of an unusually large amount of rail," "without any stipulation that security should be given by the defendant company, or that payment therefor should be made out of any particular fund or in any particular way," taken in connection with the above allegation, that the rail was sold relying upon the supposed terms of the mortgage, rendered the trial court powerless to prefer appellant's claim.

20 Am. & Eng. Ency. of Law, p. 431, note 3.
Broom's Legal Maxim, p. 650.
Wood vs. Guaranty Co., 128 U. S., 416.
Adison vs. Lewis, 9 Am. & Eng. Ry. cases, 702.

Seventh Proposition.

The master finds substantially that when the contracts were entered into the condition of the track of the railway company was such that the demand for new rails upon the most worn portions was practically imperative; that for a number of years prior to December, 1882, only about 5,000 tons of new rails had been purchased; that the condition of the road was bad, except such portions as had been relaid with said 5,000 tons; that there was continuous breakage of rails, and wrecking of trains; that the track was unsafe, and was generally so regarded, not only by railroad men, but by the traveling public; that the damage to merchandise, rolling stock, etc., was continuous, and the need of new rails appears to have been absolutely necessary as a preservation of human life, the loss of which was liable to occur at any time; that when the contracts were made both seller and buyer expected the debt to paid from the net income of the road;

that the credit extended under said contracts was at the request of, and for the accommodation of the Railway Company, but he finds further that the rails were sold upon the general credit of the Railway Company, and that said sales were made without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund, or in any particular way; that said sales were for an unusually large amount of rails, and the defendant company was unable to pay cash therefor, and that petititioner at the time of said contracts and sales had knowledge of the mortgage declared on herein.

The findings further show that the bonded indebtedness of the Railway Company, when the rails were sold, was $16,874,500, which was $33,087.20 per mile, and the floating indebtedness in 1884 was $3,584,251.30. That petitioner knew of the bonded indebtedness of the company, and probably knew of its floating indebtedness, both of which were large, and hoped and expected to realize the amount of the sales out of the net income of the road, but for no other reason, as no promise was made to that effect.

We submit that the foregoing findings show that the Railway Company had operated its road until its track had become practically worn out, and that it had become suddenly necessary to rebuild anew its entire track. It was, therefore, necessary to purchase an unusually large amount of rails. For this reason the rails were sold upon the general credit of the company, upon long time of payment, and the purchases cannot be classed as other than material bought for general and original construction.

STATEMENT.

The master finds: "I find that the debt for which the Lackawanna Company claims payment in its petition herein cannot be classed as a current debt made in the ordinary course of business as those terms seem generally to be understood, yet it appears that at the time when the contracts hereinbefore mentioned were entered into between said Lackawanna Company and the defendant Railway Company that the condition of the track of the defendant Railway Company was such that the demand for new rails upon the most worn portion of the roadway was practically imperative. For a number of years prior to December, 1882, only about 5,000 tons of new rails had been purchased. The road north from Houston for 90 miles was built in 1857, 1861, and thence northward to Denison, 1867, 1872. The western division leading to Austin was constructed in part prior to 1861, and completed in 1873, and the Waco division was completed about 1875. The condition of these roads was bad, except such portions as had been relaid with 5,000 tons of rails purchased prior to December 28, 1882. There was continual breakage of rails and wrecking of trains, the track was unsafe, and was generally so regarded, not only by 'railroad men,' but by the traveling public; the damage to merchandise, rolling stock, etc., was continuous and the need for new rails appears to have been 'absolutely necessary as a preservation of human life; the loss of which was liable to occur at any moment.'

"I find that when the aforesaid contracts were made with the said Lackawanna Company both seller and buyer expected the debts to be paid from the net income of the railway; that the credit extended under said contracts was at the

request of and for the accommodation of the defendant Railway Company, and upon its general credit; that said sales were made without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund or in any particular way; that said sales were for an unusually large amount of rails, and the defendant was unable to pay cash therefor, and there was no other way of obtaining said rails except upon credit; and petitioner herein at the time of said contracts and sales had knowledge of the mortgage of June 16, 1873, given by the defendant Railway Company upon the properties of its Waco and Northwestern division to secure the first mortgage bonds, which said mortgage has been herein foreclosed."

"I find that the steel rails supplied by said Lackawanna Company, under the aforementioned contracts, 18,581 tons, were placed in the track of the defendant Railway Company as soon as received."

VII.

"I find that the bonded debt of the defendant Railway Company January 1, 1885, was as follows:

1st mortgage, main line, 7 per cent	$6,262,000
1st mortgage, Western division, 7 per cent....	2,270,000
1st mortgage, W. & N. W. Div., 7 per cent....	1,140,000
Consolidated M. L. & West. Div., 8 per cent...	4,118,000
Consolidated W. & N. W. Div., 8 per cent....	84,000
General mortgage, 6 per cent.....	3,000,000
Income and indemnity.....	500
Total.....	$16,874,500

If the foregoing findings do not show the claim of the petitioner to be in every sense in which those terms are used, "a claim for general and original construction," it is more analogous to that class than to any other class of claims usually asserted in this character of litigation, and we believe that the authorities governing that class of claims should be applied to petitioner's claim."

AUTHORITIES.

Wood vs. Guaranty Co, 128 U. S., 416.

Addison vs. Lewis, 9 Am. & Eng. R. R. Cases, 702.

Am. L. & T. Co. vs. East, etc., Ry. Co., 46 Fed. Rep., 101.

Eighth Proposition.

A claim will not be decreed priority because the material furnished was necessary to the maintenance of the road and to keep it a going concern, for if this were so a party who loaned the Railway Company money in time of financial distress would occupy a position superior to all others and be entitled to the greatest consideration, for money is representative of all material wants, and will serve every purpose toward the maintenance of the road and keep it a going concern.

Morgan's L. & T. Ry. Co. vs. Texas Central Ry. Co., 137 U. S., 171.

(S. C.) 45 Am. & Eng. Ry. Cases, 631.

Tenth Proposition.

Appellant would not be entitled to priority by virtue of the laws of Texas as claimed, because the only law of that

state that pretended to give the claimed priority has long since been declared by the Supreme Court of Texas to be unconstitutional.

Giles vs. Stanton, 86 Texas, 620.
Receivers vs. DuBose, 87 Texas, 78.

In conclusion, we beg to quote from a few of the leading cases on the subjects discussed in this brief. In the case of Blair vs. Ry. Co., 22 Fed. Rep. 474, Mr. Justice Brewer has drawn a clear distinction between sales of supplies made on time voluntarily extended to the road and those made on temporary credit resulting from the peculiar nature of railroad business, affirming that business of such magnitude cannot be transacted on a cash basis, and that in the very nature of this business, *temporary credit* is indispensable. He says:

"The idea which underlies them, I take to be this: That the management of a large business, like a railroad business, cannot be conducted on a cash basis. Temporary credit in the very nature of things is indispensable. Its employes cannot be paid every month. It cannot settle with other roads its traffic balances at the close of every day. Time to adjust and settle these various matters is indispensable. Because in the nature of things this is so, temporary credit must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road, and having it preserved as a going concern, and whatever is necessary to accomplish this result must be taken as assented to by the mortgagees."

In Heidekoper vs. Locomotive Works, 99 U. S., 260, it is said by Chief Justice Waite: "The Railroad Company

contracted to buy the engines and pay a certain price. The locomotive company retained a paramount lien to secure the sum to be paid. The debt so incurred was not paid * * * So far as we can see no equitable claim upon any fund in Court has been established as security for this debt. The locomotive company occupies the position of a general creditor with no special equities in its favor."

The amount claimed in the above case was a balance due after the lien on the locomotive had been foreclosed.

In the case of Kneeland vs. Am. Loan Co., 136 U. S., 97 and 98, Mr. Justice Brewer used this very forcible language in reference to the character of claims here asserted: "Upon these facts, we remark, first, the appointment of a receiver vests in the Court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a Court appointing a receiver acquires power to give such preference to any general and unsecured claims. It has been assumed that a Court appointing a receiver could rightfully burden the mortgaged property for the payment of an unsecured indebtedness. Indeed, we are advised that some Courts have made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgage liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations? One holding a mortgage debt upon a railroad has the same right to demand and expect of the Court respect for his vested and contracted priority as the holders of a mortgage lien on a farm or lot. So,

when a Court appoints a receiver of railroad property, it has no right to make that receivership conditional on the payment of other than those few unsecured claims which, by the ruling of this Court, have been declared to have an equitable priority. No one is bound to sell to a railroad company, or to work for it, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility, and not in the expectation of subsequently displacing the priorty of the mortgage liens. It is the exception, and not the rule, that such priority liens can be displaced. We emphasize this fact of the sacredness of contract liens, for the reason that there seems to be growing an idea that the chancellor in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens. Railroad Co. vs. Railroad Co., 125 U. S., 658, 673. So that these intervenors acquire no right of priority by virtue of their antecedent contracts of sale."

To the authorities cited in this brief, we add the following:

1. On the question of allowing back debts of longer standing than six months:

20 Am. & Eng. Ency. of Law, p. 425 and cases cited.

Blair vs. Ry. Co., 22 Fed. Rep., p. 471.

In re Kelly, 5 Fed. Rep., p. 846.

2. On the question of the propriety of a Court of equity to give claims of the character herein asserted priority over a prior mortgage:

Forman vs. Central Trust Co., 71 Fed. Rep., p. 776.

Railway Company vs. Cowdy, 11 Wall, 482.

Central Trust Co. vs. Chattanooga Ry. Co., 69 Fed. Rep., 295.

Thompson vs. Valley Ry. Co., 132 U. S., 68.
Farmers' & Merchants' Nat. Bk. vs. Ry. Co., 36 S. W. R., 131.
Foggs vs. Blair, 133 U. S., 534.
Toledo Ry. Co. vs. Hamilton, 134 U. S., 296.
Trustees vs. Ry. Co, 2 Wood, 542.
Denison vs. Ry. Co., 4 Biss, 416.
High on Receivers, Sec. 394a.
Express Co. vs. Ry. Co., 99 U. S., 191.
Turner vs. Ry. Co., 8 Biss, 315.
Miltenberger vs. Ry. Co., 106 U. S., 286.
Trust Co. vs. Souter. 107 U. S., 591.
Burnham vs. Bowen, 111 U. S., 776.
Blair vs Ry. Co., 22 Fed. Rep., 471.
L. C. & N. Co. vs. Ry. Co., 29 N. J. Eq., 252.
Hale vs. Frost, 99 U. S., 389.
In re Kelly, 5 Fed. Rep., 846.
Bridge Co. vs. Douglas, 12 Bush, 673.

We submit, with confidence, that appellant has not shown that it is entitled to equitable priority of payment, either out of the proceeds of sale or net income arising from the operation of the road, or that there is error in the decree appealed from and we request that it be in all things affirmed.

L. W. CAMPBELL,
Solicitor for Moran Bros. and Henry K. McHarg, Appellees.

Filed Oct. 11, 1897.

UNITED STATES CIRCUIT COURT OF APPEALS,

FIFTH CIRCUIT.

No. 502.

LACKAWANNA IRON & COAL COMPANY,
APPELLANT,

vs.

FARMERS' LOAN AND TRUST COMPANY ET AL.,
APPELLEES.

SUPPLEMENTAL BRIEF OF MORAN BROS. AND HENRY K. MCHARG.

(REPRINT.)

L. W. CAMPBELL,
Solicitor for Appellees Moran Bros. and Henry K. McHarg.

UNITED STATES CIRCUIT COURT OF APPEALS.

FIFTH CIRCUIT.

No. 503.

LACKAWANNA IRON & COAL COMPANY,

APPELLANT,

versus

FARMES' LOAN AND TRUST COMPANY ET AL.,

APPELLEES.

SUPPLEMENTAL BRIEF OF MORAN BROS. AND HENRY K. MCHARG.

(REPRINT.)

A supplemental brief is made necessary, because the brief filed within the time prescribed by the rules for appellees was prepared without any opportunity to see the brief for appellant, and was prepared upon the supposition that appellant's brief, when prepared and filed, would be predicated upon appellant's assignment of error, and in accordance with the rules of this court. Because this has not been done, and because of many inaccuracies, omissions, misstatements of the record, and violations of the rules of this court in the

preparation of said brief, we file this our supplemental brief and argument.

First.—We find in appellant's brief, from pages 1 to 5, a statement of what purports to be the substance of appellant's petition. Our principal objection to this is that it omits to state the very material allegation that appellant in selling the rail relied for its security upon the supposed existence of a clause in the mortgage declared on herein providing for the payment of floating debts in case of default, and possession is taken under the terms of the mortgage (see 18th paragraph, appellant's petition, R. p. 627). Appellant in making this statement also overlooks the importance of stating fully and fairly all issues made by the pleadings of all parties. This Court should have been informed in that connection that appellees pleaded the Texas statute of four years' limitation, and that appellant's claim was stale and barred by laches, and on this issue the master found that appellant's notes were not sued on in the District Court of Dallas county, Texas, until April 30, 1889, and that they had never been renewed or extended, and that appellant under the second contract sold the rails to the Houston & Texas Central Railway Company, a year and ten months prior to the receivership in cause 185, three years and three months prior to the receivership in cause 198, and six years prior to the receivership in this cause, and that under the third contract it sold the rail under a contract dated sixteen months prior to the receivership in cause 185, two years and nine months prior to the receivership in cause 198, and five years and six months prior to the receivership in this cause. Appellant also omits to state that upon these issues and others presented by pleading and proof, the Court below found generally against appellant and dismissed its petition, and

filed no written opinion, and that appellant has appealed from said decree and assigns no errors attacking the decree appealed from, if based upon the issues made by the pleading and proof that the claim is stale and barred by limitation.

Appellant also fails to state that the case was heard by the trial court upon both the master's report and upon evidence (see decree, R. p. 681) that appellant filed no exceptions to the master's report, and has not brought up with the record the evidence either taken before the master or heard by the Court in connection with the report.

Second.—On pages 6 and 7 of appellant's brief we find a statement of what appellant's counsel conceive to be due on the second contract. On this subject the master finds as follows: "I find that 6.2 miles of the railway of the Waco and Northwestern division of the Houston & Texas Central Railway Company was laid with rails furnished under the first two above named contracts, *but no evidence was submitted to me showing what proportion of said rails were furnished under each of said contracts respectively.*" Appellant having made no effort to prove the facts as to the amount of rails laid on this 6.2 miles out of the first and second contracts respectively, and having filed no exceptions to the master's report, and without assigning any error, or laying any predicate for raising such a question in this Court, now coolly asks this court to go into an examination of that question. This Court will not assume the burden of patching up appellant's case by guessing at the number of rails laid down under the first and second contract on this 6.2 miles. Aside from this, under agreement of counsel made before the master, and by him reported to the Court, all rails under

the second contract (so far as these bondholders have any interest in that matter) are paid for by the 170 bonds hypothecated by the Houston & Texas Central Railway Company with the Lackawanna Iron & Coal Company as collateral security to the notes given for the balance due under the second contract. On this subject the master finds as follows: "It was agreed by counsel that without making any actual sale of the said 170 bonds the Court should consider the same as sold for said amount of $157,250 on December 23, 1895, and should apply same as a credit as of said date, upon the claim of the Lackawanna Iron and Coal Company, or of the Southern Development Company, as the Court may determine." (R. p. 652).

It will be remembered that only $118,000 remains unpaid on the second contract. Deducting the $118,000 from the $157,250 leaves an overpayment of $39,250 out of the collateral security. The bondholders have the undoubted right to insist that the collateral security hypothecated shall be exhausted before the appellant would be allowed to go upon the common fund. In the case of Thomas vs. Western Car Company, 149 U. S., page 116, the Court say: "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency interest is not allowed on the claims against the funds The delay in the distribution is the act of law; it is a necessary incident to the settlement of the estate." So that the Court could only deal with the principal sum due, and which is clearly shown to be overpaid nearly $40,000.

Third.—Not having time to notice all the inaccuracies in appellant's brief, we pass to the consideration of what is said in the third, fourth, sixth, seventh, eighth, ninth, tenth,

eleventh and twelfth subdivisions, found on pages 18 to 21 inclusive.

Appellant's counsel states in the third subdivision, page 18, referring to these rails: * * * "by their use the railway of the defendant company was kept in safe running order, its business increased, its railway thereby rendered more valuable to the bondholders under the various mortgages thereupon, and especially to the bondholders under the deed of trust and mortgage sought to be foreclosed in the proceeding now before the Court." There is no warrant or authority in the findings of the master for such a statement as this. He does not in the remotest refer to the question as to what effect the placing of these rails had upon the business of the company, or whether it rendered the security more valuable to any of the bondholders.

It is true he finds that before and at the time the rail were purchased that the demand for new rail was practically imperative, etc., and that the rail were put in as fast as they arrived. But here the story ends abruptly. We hear nothing more on this subject. There is no intimation as to the effect of placing the rail in the roadbed had on the subsequent business of the company, whether its net income income increased or diminished, or what effect if any the purchase and laying of this rail on thirty-seven miles of the Waco and Northwestern division had on the value of the bondholders' security. The fact is this subject is not in the remotest alluded to by the master.

We find in this same third subdivision this further statement: "The contracts were made and the rails furnished under the expectation and belief that they would be paid for out of the revenues and earnings of the property, and if

these were insufficient, out of the proceeds of sale thereof, but the defendant, instead of paying the debt due the Lackawanna Company out of the said earnings, used the earnings for the purpose of paying coupons upon the bonds secured by mortgage, upon which bonds the bill of foreclosure now before the court was filed." There is no warrant or authority for this statement in the findings of the master. The master finds on this subject as follows: "I find that when the aforesaid contracts were made with the said Lackawanna Company, both seller and buyer expected the debts to be paid from the *net* income of the railway." (R. p. 656.)

It will be seen from this finding that appellant did not expect any payment out of the gross or current revenues of the road, but only out of the net revenues. Chief Justice Waite, in the case of Fosdick vs. Scholl, thus defines net income: "The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements."

The distinction, therefore, is clear between gross and net revenues, and as appellant did not expect to be paid out of the gross or current revenues, but only out of the *net* revenue, its claim is, therefore, reduced to the level of general and floating debts. This finding of the master was not excepted to, and no assignment of error is predicated thereon. As to the latter portion of the above statement that the expectation was to be paid out of the proceeds of the sale of the property if the earnings were not sufficient, there is no warrant, except upon the unproved assertion to be found in appellant's petition. The master on this subject found: "That the credit extended under such contracts was at the

request of and for the accommodation of the defendant railway company and upon its general credit. That said sales were made without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund, or in any particular way. That said sales were for an unusually large amount of rails and the defendant was unable to pay cash therefor." (R. pp. 656-7.)

The assertion found in the above quotation, either in referring to the defendant railway company, or to the receivers, that they used the earnings for the purpose of paying coupons upon bonds secured by the mortgage, is also without any warrant or authority. On this subject the master finds: "I further find that the accounts of the railway company were not kept in such a manner as to indicate the exact fund out of which the interest on said first mortgage bonds of the Waco and Northwestern division were paid, or the exact fund out of which the interest upon the bonds of the other division was paid, and that no separate account was kept of the net earnings of said Waco and Northwestern division, as distinguished from the net earnings of the other divisions of said railway company either prior to or during the receivership thereof until April 20, 1889, or thereabouts." (R. p. 680.)

In the last portion of said subdivision 3, page 18, we find the following statement: "The rails were actually used for the betterment and improvement of the railway, and not for the purpose of construction." There is no warrant or authority in the findings of the master for this statement. He finds "that said sales were for an unusually large amount of rails," and he further finds "that the rails were placed in the

track of the defendant railway company as soon as received." (R. p. 657.) But he does not find or attempt to draw any such distinction as is made in this statement, but the inference is clearly deducible from his finding that the sales were for an unusually large amount of rails, that he considered the purchase as analogous to original construction, and was clearly a purchase on general merchandise account, and there is no other finding of fact on this subject.

Fourth—In the fourth subdivision, beginning at the bottom of page 18 and extending to page 19, we find the statement that the $91,371 paid to the bolders on the Waco and Northwestern division was paid before any proceedings whatever had been taken to impound the revenues of the defendant, or to affect them with any right whatsoever in favor of the bondholders. There is no warrant or authority whatever in the record to support this statement. The record shows that the first mortgage bondholders filed a general demurrer to the bill of the Southern Development Company, which was in May, 1886, in all things sustained, and cause 185 was dismissed, and receivers were appointed at the suit of the first mortgage bondholders on July 10, 1886, and said receivers held said property and net revenue by virtue of said appointment, and it was not until something like a year thereafter that the said $91,371 was paid as interest on the bonds on the Waco and Northwestern division, and there is no warrant for the statement that the $91,371 was paid out of the revenue of the railway. This is fully shown by the above quotation from the master, "that the accounts were not kept in such a manner as to indicate out of what funds these payments were made."

Fifth—In the seventh subdivision, on page 20 of appel-

lant's brief, we find that there was net revenue arising from the operation of the entire system by the receivers in cause 185, from February 23, 1885, to July 10, 1886, amounting to $423,142.16, but there was no interest payment made out of this fund to the bondholders on the Waco and Northwestern division, nor has any of this fund ever come into the hands of the receiver in this cause, and none of the improvements, if any, erected out of said fund, or any funds in the hands of the receiver in cause 185, were put upon the Waco and Nortwestern division. On this subject the master finds: "I find that no part of the income arising from the operation of the road, and no part of the proceeds of sales of old rails, old iron, old cars and engines, which was received by the receivers in causes Nos. 185 and 198, ever came into the possession of the receiver in this cause and the evidence fails to show that any part of the new equipments purchased by the receivers in causes Nos. 185 and 198, as shown above, ever came into the possession of the receiver in this cause. And the evidence fails to show that any improvements and betterments of the property added to the property of the Houston & Texas Central Railway Company, by the receivers in causes Nos. 185 and 198 were made on the Waco and Northwestern division." And further on he finds: "I find that the receivers in cause No. 185 had on hand in cash at the opening of business on January 21, 1886, $175,393.65, but there is no evidence that any part of said fund came into the possession of the receiver in this cause. I find that the receiver in cause No. 198 had on hand at the beginning of business on April 6, 1889, cash amounting to $215,842.54, but the evidence does not show that any part of said funds came into the hands of the receiver in this cause." The master finds and shows that the Waco and Northwestern di-

vision was operated as a part of the general system of the Houston & Texas Central Railway Company up to the time it was placed in the hands of a separate receiver on April 6, 1889, and his findings lead to the conclusion that a systematic method of favoritism was kept up during this entire time, appropriating the revenues of the Waco and Northwestern division without adding any betterments or paying any interest whatever upon the bonds held by the bond holders thereon. That these bond holders have received no interest whatever on these bonds for a period of over nine years, and for the same length of time only the sum of $46,505.40 was added thereto as betterments and permanent improvements, and that was done by the present receiver since December 10, 1892.

Sixth—The tenth subdivision found on page 21 is misleading and inaccurate, and we prefer that the Court would read the master's finding on this subject, and which has been quoted by us above.

This disposes of the most prominent inaccuracies that we have found in the brief for appellant. There may be others, but we have not time to point them out.

Seventh—On page 23 we find this statement in reference to appellant's method of presenting his assignments to this Court: "Instead of following the assignments of error closely, we think we can present the case more satisfactorily to the Court by discussing it in the manner in which we shall." The manner in which they do discuss this case is to invite a reconsideration of the whole case, with slightly any reference to the assignments of error, and a discussion of questions not raised, or in the remotest alluded to in any of

the assignments of error. We agree with counsel that they do not follow these assignments very closely, if at all. They start out with three propositions found on pages 23 and 24 of their brief, and while it may be barely possible that the first proposition is included in the broad, sweeping, general and inconclusive terms of appellant's assignments of error, propositions two and three found on page 24 not only have no application to the case, were not raised or presented in the lower Court, but are not in the remotest alluded to in their assignments of error, yet when they come to consider these questions they group together at the bottom of page 24 propositions one and two and ask this Court to consider the two together, when one of them is not raised by any assignment of error, and it is extremely doubtful that the other is.

We will first dipose of the second and third propositions found on page 24. It is therein asserted that the Farmers' Loan and Trust Company and the beneficiaries in the mortgage have never had a lien upon any of the earnings of the Waco and Northwestern division of the Houston and Texas Central Railway Company, and that they have no lien upon any such income now in the hands of the Court. The third proposition is that "if neither party has, nor at any time during this litigation has had, a lien on the income of the railway mortgaged in this case, then the Court will proceed upon the principle that equality is equity, and will distribute the income ratably among all of the creditors of the defendant railway company before the Court."

As stated above, neither of these propositions are included in any of the assignments of error, or was ever raised before in this case. The question for this court to determine is,

has appellant any charge or lien on the earnings of the Waco and Northwestern division of the Houston & Texas Central Railway Company? It is not material to this appeal to determine whether the bond holders have a lien on this fund.

But should this Court conclude to notice these propositions, we wish in that connection to refer to appellant's petition (R. p. 16), and the master's report thereon (R. p. 648). The subject is not in the remotest referred to in either, so far as we have been able to find, after a careful examination. But a sufficient answer to these arguments is that the record shows that the receiver in cause 227 was appointed on April 6, 1889, at the suit of the trustee in the mortgage. In such case it is not of the least importance whether there is any mortgage in existence. The appointment of the receiver, and his taking possession of the property, is an equitable levy on the income for the benefit of the moving party. This proposition is as old as the law of receiverships, and has never been doubted by any court within our knowledge, and is not disputed by appellant's counsel (see Sage vs. Memphis & L. R. Ry. Co., 125 U. S., 40.) But the provisions of the mortgage is an equitable mortgage on the income, to be effective only when possession is taken after default. Such provisions are commonly and uniformly held to be effective as mortgages of the income after possession is taken (see Stanton vs. Gay, 86 Texas; 20 Am. and Eng Ency. of Laws, p. —.)

The burden of proof was on the appellant to establish an equity in this revenue; having failed to do this, its petition was dismissed generally, without making any disposition of the revenue in the hands of the Court. There was no prop. osition either in the Court below or by the assignments of error to make pro rata distribution of the revenues among

the various creditors of the company, and we don't believe that this Court in the state of the record will enter upon the speculative investigation suggested by propositions 2 and 3. Propositions 2 and 3 being disposed of, leaves for consideration what is said by appellant in its first proposition, the substance of which is that it has in equity a charge on the continuing income of the railway both before and after the appointment of receivers, and that the Court should use the income in the way that the company would have been bound to use it in the discharge of appellant's debt, and that said income has been diverted from the payment of appellant's debt to the payment of mortgage creditors and the improvement of the mortgaged property, and to the extent of such depleted income appellant should be reimbursed out of the proceeds of sale of the mortgaged property. If we were certain that appellant would be content with this proposition, we could with more ease to ourselves proceed to the discussion of the question. It seems from this proposition that they confine their claim to the right to be reimbursed "out of the proceeds of sale of the mortgaged property," and does no longer contend that appellant is entitled to be reimbursed out of the net revenue in the hands of the Court We presume from this abandonment that appellant is content that the fund be paid to Mr. Downs. We refer to the case of Cutting vs. Tavares O. & A. R. Co., 61 Fed. Rep., at p. 156, opinion rendered by Judge Pardee. He says: "As the Court in appointing the receiver made no provision for the payment of said claims, and as there is no evidence in the record tending to show that the current earnings, either before or after the receiver was appointed, were diverted to paying unearned interest, or in fact any interest upon the bonded indebted-

ness, we are unable to sanction the order authorizing the payment of said claims from the proceeds of the sale of the property."

Appellant's counsel will not contend that there is a provision in any of the orders appointing receivers in any of the causes for the payment of back debts, and it is equally certain, though not conceded by appellant's counsel, that it has not been shown or found by the master, that any of the revenue, either before or after the appointment of the receiver, has been used for the erection of betterments or permanent improvements upon the Waco and Northwestern division, or for the payment of bonded indebtedness due on the bonds secured by the mortgage declared on herein.

We refer again to what the master says on this subject. He finds very distinctly "that the accounts were not kept in such a manner as to indicate the exact fund out of which the interest on said mortgage bonds on the Waco and Northwestern division were paid, or the exact fund out of which the interest upon the bonds of the other divisions were paid, there being no separate accounts kept."

In the case of Kneeland vs. American Loan Company, 136 U. S., page 97, it is said among other things: "It is the exception, and not the rule, that such priority liens can be displaced." The burden was upon appellant to prove that the improvements were erected on the Waco and Northwestern division and the interest paid on the bonds was paid out of the current income, in order to show a diversion and to establish the proposition contended for. No presumptions will be indulged by this Court in favor of appellant's case, and while the master finds that the receiver, Abeel, after December 10, 1892, and prior to September 3, 1895, ex-

pended $46,505.40 for betterments and permanent improvements, he does not find that these improvements were erected out of the current income, or state out of what funds they were erected. (R. p. 663–4.) And these are the only improvements that have been erected on the Waco and Northwestern division of over eleven years, and they were erected nearly ten years after the rails were sold.

Eighth—Passing to page 26 of appellant's brief we find with some astonishment that counsel enters upon the general discussion of the question as to whether its claim was barred by laches. There is no assignment of error authorizing the presentation of this question by appellant. The complainant and these appellees specially pleaded that the claim was stale and barred by the Texas statute of limitation. On these issues, together with a large number of other issues presented in the case, the Court found generally against appellant, and could have very properly based its judgment upon the fact that the claim was stale and barred by limitation. But appellant has assigned no error complaining of the decree, if based upon these issues. This has been fully shown in our principal brief, and if the issues are fairly made and fairly supported by the testimony it is only necessary for this Court, in order to determine this appeal, to look to those issues, and if it is determined that it would not have been fundamental error for the Court below to decide the case on those points then it logically follows that the decree appealed from must be affirmed. Appellant does not say that it was erroneous to so render the decree.

Ninth—Counsel for appellant next takes up a large portion of its brief in extended quotations from the leading cases which have discussed questions of priority of various special

and limited claims over the mortgage bond holders, but in each and every one of these cases it will be found that the Court finds either that there was a diversion of the current revenue, used in paying either bonded indebtedness or the erection of permanent improvements, or that the claim allowed was found to be in fact a claim for current supplies needed from day to day, to keep the road a going concern, or some other special equity which addressed itself to the discretion of the chancellor in allowing the claim and giving it priority, but in this case there is no finding, and there is no fact by which it may be found by this Court that there has been any diversion of the current income to the erection of either improvements on the property or to the payment of bonded indebtedness, nor is it found that the rails were a part of the current expenses or current supplies needed to keep the road in operation from day to day as a going concern, but the inference is clearly to be drawn from the master's finding that this is a claim for general merchandise sold on the general credit of the company, and constitutes a part of its general floating indebtedness.

Without attempting to follow the argument of appellant or to review the cases cited, we beg to submit that the findings of the master and the law arising thereon sustains the decree appealed from upon all the following issues:

1. That the claim of the Lackawanna Company is a general or floating debt.

The master finds that the credit extended under these contracts was upon the "general credit" of the company. That "the sales were of an unusually large amount of rails, and the defendant was unable to pay cash therefor." The inference from this is that the company was unable to pay cash

because of this unusually large purchase. He finds that "the claim cannot be classed a current debt," that appellant only expected to be paid out of the "net income," and appellant alleges that it sold the rails relying upon the supposed existence of a clause in the mortgage providing for the payment of floating debts. On these facts the Court could have, and probably did, find appellant's claim to be one for general merchandise and a floating debt. But there is no assignment of error complaining of the decree if based on that ground. Debts of that character are never given priority.

Bound vs Ry. Co., 58 Fed. Rep., 480.
Thomas vs. Car Co., 149 U. S., 95.
Kneeland vs. Trust Company, 136 U. S., 89.
Note to case of Blair vs. Railway Company, 22 Fed. Rep, 478, note 2.

Before the decree will be reversed it must be shown by proper assignments of error that it can not be sustained on any of the defences urged against appellant's claim (Walker vs. Cole, 34 S. W. R., 713.)

2. That the debt is barred by the Texas statute of four years' limitation. This is fully shown on the merits under ninth proposition, pages — to — in these appellees' brief. That the issues of law and fact raised would have warranted the trial Court in deciding the case on those issues is there fully shown. That appellant does not by assignment of error complain of the decree if based thereon is fully shown on pages 9 and 10 of appellees' said brief.

3. That the debt is stale, in that the rail was sold too long prior to the appointment of receiver to be classed as a current debt for supplies. This fully shown on pages — to

— of the brief for appellees. There is no fixed or invariable rule on this subject. It must have been a reasonable time prior to the appointment of a receiver. What is a reasonable time is a question of fact (not of law, as stated in appellant's brief, page 34), and the trial Court having resolved that fact against appellant and held its claim to be barred by laches because the time was unreasonable, that action will not be reviewed by this Court in the absence of proper assignments of error complaining of the decree if based on that ground. There is no assignment of error which raises that question. The master finds that the rails delivered under the last contract were sold under a contract made sixteen months prior to the appointment of the receiver in cause No. 185, two years and nine months prior to the receivers in cause 198, and five years and six months prior to the receivers in this cause (R. p. 655). Whether or not this was a reasonable time was to be judged from the the testimony. The trial judges may have and probably did conclude that this period was an unreasonable time. In the absence of an assignment of error this action is conclusive and not subject to review by this Court. The decree shows that the trial court heard the evidence in connection with the master's report (R. p. 681). Its conclusion on this question cannot be reviewed by this Court. Indeed, if it were necessary to do so to sustain the decree appealed from, it would be presumed that the trial court held the claim to be stale. This is so, because the decree is not complained of if based on that ground.

4. That there has been no diversion of the income to the payment of interest and the erection of improvements. This is fully shown on pages —— of this supplemental brief, and pages —— to —— of the original brief, under fourth

proposition. There is no assignment of error complaining of the decree, if based on that ground. The third assignment of error states as a matter of fact in general terms that there has been a diversion, and complains only that the Court erred in not decreeing a restoration. But it does not complain that the Court erred in holding that there had been *no* division. The assignment assumes as a fact, independent of any ruling on that subject, that there had been a diversion of the income, but if the lower court differed with counsel, and found that there had not been, or that the evidence failed to show that there had been, its conclusion on that subject is binding on this Court, for it is not anywhere assigned as error. This being a Court of review it is not concerned so much with what are the facts, but what was found to be the facts, and what is complained of by the assignments of error. The trial court could not err in refusing a restoration until it had been determined that there had been a diversion. And not until it is complained of by an assignment of error that the Court erred in holding that there had been no diversion, will this Court review the question as to whether the Court erred in refusing to restore the fund.

5. That if petitioner has any equity it should be remitted to its intervention now pending in cause No. 198, which is a receivership covering the entire system. This is fully shown by the brief for these appellees on pages 22 to 28, under fifth proposition. This is what was practically done by the decree appealed from. Appellant's petition was dismissed without prejudice to its intervention in cause No. 198 (R. p. 681), and with this reservation, it is a difficult question to determine, unless the outside facts are known, just why this appeal is prosecuted so vigorously against a small

branch of the road. No error is assigned if the decree is based upon the ground that the rights of appellant, if any it has, must, under the facts reported by the master, be asserted in that cause.

6. That appellant in selling the rail relied upon the supposed existence of a provision in the mortgage requiring the payment of its claim, and did not expect to be paid out of the current income, but only out of the net income, and can assert claim in no other manner. Appellant alleges that it did sell the rail upon the faith of this mortgage, and the master finds that it expected to be paid out of the net revenue (see allegations in petition, R. p. 627, and findings of the master, R. p. 656). This allegation in connection with this finding of the master makes a case wherein appellant sued upon the mortgage claiming under the terms of an express contract made for its benefit. It failed, however, to prove its case. The Court could very properly and may have found against appellant on this ground. It certainly would not be a case of plain error to so find, for it could be nothing short of justice to give to appellant the full protection of its own contract and expectations thereunder. The allegation has never been modified or amended. No error is assigned complaining of the decree if based upon that ground.

We submit that nothing has been shown by appellant indicating that error exists in the decree appealed from, and we request that it be affirmed.

Respectfully submitted,

L. W. CAMPBELL,
Solicitor for Appellees Moran Bros. and Henry K. McHarg.

No. 451. No 2.
Brief of Turner for Respondents
Filed Oct. 16, 1897.

Supreme Court of the United States,

OCTOBER TERM, 1897.

No. 451.

THE LACKAWANNA IRON AND COAL COMPANY ET AL.,

Petitioners,

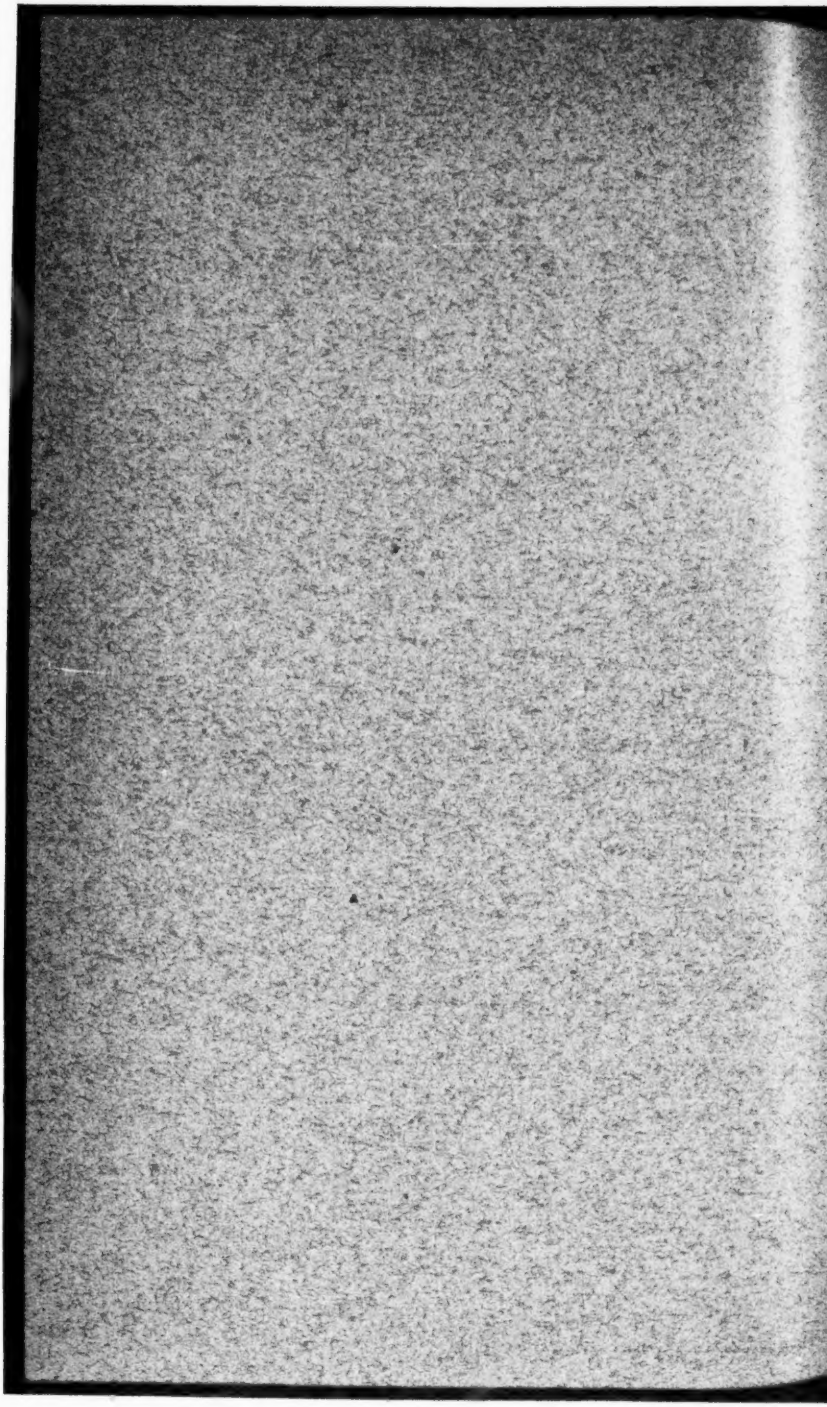
versus

THE FARMERS' LOAN AND TRUST COMPANY ET AL.,

Respondents.

MEMORANDUM OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

HERBERT B. TURNER,
Of Counsel for the Respondents.



Supreme Court of the United States.

THE LACKAWANNA IRON AND COAL COMPANY, *et al.*,
Petitioners,

vs.

THE FARMERS' LOAN AND TRUST COMPANY *et al.*,
Respondents.

Memorandum of The Farmers' Loan and Trust Company in opposition to the petition for a writ of certiorari to the Circuit Court of Appeals for the Fifth Circuit.

This petition presents an extraordinary instance of the difficulties which stand in the way of holders of railroad securities in enforcing their liens. The matter now before the Court is an intervention of an unsecured creditor, the Lackawanna Iron and Coal Company, which had supplied the Houston and Texas Railway Company with steel rails and had accepted its notes in payment. A suit being brought by the Farmers' Loan and Trust Company, as trustee of a first mortgage covering the Waco branch of the Houston and Texas Central,

which mortgage was made a number of years before the purchase of the rails, this creditor intervened in that suit, claiming a lien prior to the lien of the mortgage.

The Houston and Texas Central Railway Company, a large Texas corporation, made several mortgages, one covering its main line in 1866, and others covering the branch lines from 1870 to 1877. There were several branch lines. One of these, called the Waco Branch, is the subject matter of the present litigation. On this particular branch the Houston and Texas Central placed two mortgages, a first and second, each to secure a separate series of bonds. The first is dated June 16th, 1873.

It is true, as the petitioner states, that prior to the bringing of the foreclosure suit in which this intervention was filed, there had been litigation affecting this entire railroad company, but this fact does not seem very material here. Receivers of the Houston and Texas Central Railway Company were appointed by the United States Circuit Court for the Eastern District of Texas in a creditor's bill filed by the Southern Development Company, claiming to be a creditor, in February, 1885. About one year afterwards, on May 27th, 1886, the Court dismissed the bill of the Southern Development Company on demurrer, but appointed new receivers on foreclosure bills, which were filed at that time by the holders of the first and second mortgages on the main line and Western Division. These bills were consolidated.

It must be carefully noted that the holders of the First Mortgage, Waco Division, bonds, secured by the mortgage under foreclosure in this cause, did not then file a bill to foreclose their mortgage, inasmuch as they considered their bonds perfectly good and a first-class investment at seven per cent. for a very considerable unexpired term. They discovered their error afterward.

A decree was had in the consolidated cause for the foreclosure of the mortgages covering the entire property on May 4th, 1888, and under the provisions of that decree the entire property was sold September 8th, 1888. The sale was made subject to the First Mortgage on the Waco Branch, which is the subject-matter of this suit. Indeed, the entire proceedings were subject to all rights existing under the Waco Branch First Mortgage.

After all this had happened, after the decree had been rendered and the sale had been made and the property had passed into the hands of the reorganized company, who took the same subject to the First Mortgage, Waco Division, the complainant, the Trustee under the First Mortgage, Waco Division, filed the bill in the present cause to foreclose its mortgage. It was filed April 6th, 1889.

It is not easy to see what the previous action, and the sale therein, has to do with this suit. The income of the entire property in the hands of the Receivers was devoted to the improvement of the railroad property, which was in such very bad condition that the line was popularly known as the "Angel Maker."

The complainant herein was first met by dilatory motions, which were not finally decided until October, 1890. Thereupon, the parties who had interposed these dilatory motions, and who represented the same interest as that represented by the petitioner in the present matter, demurred to the bill.

The demurrer was argued December 19th, 1890, and overruled a few days later. Thereupon, the defendants interposed an answer, which was filed on the February, 1891, rule day. Testimony was thereupon taken, with the usual delays, so that

the cause was not brought on for final hearing until March, 1892, and a decree of foreclosure and sale was rendered at that time. The decree contained the following provision respecting the claim of the petitioner, the Lackawanna Company:

"IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that the rights of the Lackawanna Coal and Iron Company * * * * intervenors herein, and the rights of all other intervenors herein, be and they are hereby reserved to be hereinafter adjudicated, and are in no manner affected or prejudiced by this decree. It is further ordered that the disposition of any surplus funds arising from the earnings of the road, or otherwise, that may be in the hands of the Receiver, is reserved for future determination."

In accordance with this decree the property was sold December 28, 1892, and struck off to E. H. R. Green for one million three hundred and seventy-five thousand dollars.

Green did not complete his purchase. On the contrary, he took proceedings to be relieved of his bid. These proceedings occupied a great deal of time, and he was finally so relieved in 1894.

The property was thereupon again advertised for sale and sold September 3, 1895, for one million five hundred and five thousand dollars. Since then we have been ceaseless in our endeavors to compel the purchaser to complete his purchase, but hitherto without success.

Although the property has been sold and a responsible purchaser has bought it, and the sale, under the terms of the decree, is subject to this Lackawanna claim and the other claims which have been overruled by the Courts, nevertheless it seems impossible to have the sale completed so long as these claims are in litigation. It is understood that the purchaser represents the same interest which holds the claim of the Lackawanna Com-

pany. So that whether the claim is sustained as prior in lien to the mortgage or not would make no practical difference. Whether this protracted litigation can be still further prolonged may make a very considerable difference to the unfortunate bondholders who have had the singular experience of holding securities which, when the reorganization was effected a few years ago, were supposed to be worth par, but which now are almost unsalable, with interest overdue and unpaid for more than eleven years.

The petition for the writ of certiorari does not present questions of sufficient gravity and importance for the Supreme Court of the United States to require the Circuit Court of Appeals to certify this case to it for review.

The Supreme Court has already declared that it will only exercise this branch of its jurisdiction sparingly and with great caution, and never excepting in cases of gravity and importance. In the case of *Lau Ow Bew, Petitioner*, 141 U. S., 583, the Court, speaking through Mr. Chief Justice FULLER, said:

"It is evident that it is solely questions of gravity and importance that the Circuit Court of Appeals should certify to us for instruction; and that it is only when such questions are involved that the power of this Court to require a case in which the judgment and decree of the Court of Appeals is made final, to be certified, can be properly invoked. The inquiry upon this application, therefore, is whether the matter is of sufficient importance in itself, and sufficiently open to controversy, to make it the duty of this Court to issue

the writ applied for in order that the case may be reviewed and determined as if brought here on appeal or writ of error."

In re Woods, 143 U. S., 202, this Court refused to grant a writ of *certiorari* on the ground that the questions were not of sufficient gravity and importance. Referring to the above case, the Court, again through Mr. Chief Justice FULLER, said :

"In the matter of Lau Ow Bew, the construction of acts of Congress in the light of treaties with a foreign government, and the status of domicil in respect of natives of one country domiciled in another, a matter of international concern, were brought under consideration upon the record, and we were of opinion that the grounds of the application were sufficient to call for our interposition.

But we do not regard the inquiry as to whether it was settled law in the State of Minnesota that a judgment of dismissal in a former suit, such as pleaded here, was not a bar to a second suit upon the same cause of action, or whether the law in respect of recovery by a servant against his master for injuries received in the course of his employment was properly applied on the trial of this case, as falling within the category of questions of such gravity and general importance as to require the review of the conclusions of the Circuit Court of Appeals in reference to them."

In *American Construction Company* vs. *Jacksonville Railway Company*, 148 U. S., 372, the plaintiff had filed a stockholders' bill against the defendant railroad company, praying for a Receiver. A Receiver was appointed and authorized to pay certain obligations of the railroad company out of the income coming into his hands and to borrow money on Receiver's notes for the same purpose. The railroad company appealed from the orders appointing the Receiver and authorizing the issue of Receiver's notes, and the Circuit Court of Appeals reversed and set aside both orders. This

Court, upon an application by the construction company for a writ of *certiorari*, refused the writ on the ground that the questions presented were not of sufficient importance.

In the course of the opinion by the Court, Mr. Justice GRAY used the following language:

"In the same spirit, the authority conferred on this court by the very provision on which the petitioners mainly rely, by which it is enacted that 'in any such case as is hereinbefore made final in the Circuit Court of Appeals, it shall be competent for the Supreme Court to require, by *certiorari* or otherwise, any such case to be certified to the Supreme Court for its review and determination, with the same power and authority in the case as if it had been carried by appeal or writ of error to the Supreme Court,' has been held to be a branch of its jurisdiction which should be exercised sparingly and with great caution, and only in cases of peculiar gravity and general importance, or in order to secure uniformity of decision. *Lau Ow Bew's case*, 141 U. S., 583, and 144 U. S., 47: *In Re Woods*, 143 U. S., 202. Accordingly, while there have been many applications to this Court for writs of *certiorari* to the Circuit Court of Appeals under this provision, two only have been granted; the one in *Lau Ow Bew's Case*, above cited, which involved a grave question of public international law, affecting the relations between the United States and a foreign country; the other in *Fabre, Petitioner*, No. 1237 of the present term, an admiralty case, which presented an important question as to the rules of navigation, and in which the decree of the Circuit Court of Appeals for the Second Circuit reversed a decree of the District Judge, and was dissented from by one of the three Circuit Judges; *and in each of those cases the Circuit Court of Appeals had declined to certify the question to this Court.*"

In the same opinion the Court further said that there were much stronger reasons against the interposition of the Supreme Court to review a de-

cree made by the Circuit Court of Appeals on appeal from an interlocutory order than in the case of a final decree.

"Clearly," said the Court, "this Court should not issue a writ of certiorari to review a decree of the Circuit Court of Appeals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause."

And the same doctrine was reiterated in *Forsyth* vs. *Hammond*, 166 U. S., 514.

It is submitted that there is no question in the present case of sufficient gravity for the Supreme Court to review the decision of the Circuit Court of Appeals. The question upon this intervention was a purely private one, concerning no one except the parties immediately before the Court. It did not involve interests of any very great magnitude, nor issues of national importance. The claim was simply that of a contractor who, having supplied steel rails to the Houston & Texas Central Railway Company for construction purposes, and accepted notes for the payment thereof. maturing from time to time during several years, upon the insolvency of that company, sought to obtain for this unsecured debt a priority of lien over a mortgage which the railroad company had made to the Farmers' Loan & Trust Company.

In paragraph XXVIII the petitioners set forth what they regard as the two important questions of law involved in the cause. The first is as to the application of the doctrine of *Fosdick* vs. *Schall* to the present claim. This question was fully argued in the Court below, and a careful opinion (reported in 79 Federal Reports, 202), reviewing all

the authorities bearing on the subject was rendered. If this Court can be called upon to examine every claim for a priority of lien based upon the doctrine of *Fosdick* vs. *Schall*, then, to that extent, the object of the Act of 1891, creating the Circuit Court of Appeals, is frustrated. That act, as was said by this Court in *American Construction Co.* vs. *Jacksonville Railway*, cited above,

> "Has uniformly been so construed and applied by this Court as to promote its general purpose of lessening the burden of litigation of this Court by transferring the appellate jurisdiction of large classes of cases to the Circuit Court of Appeals, and making the judgments of that Court final, except in extraordinary cases."

The questions growing out of the case of *Fosdick* vs. *Schall* have for more than twenty-five years been the subject of controversy before every Circuit Court in the United States, as well as many of the State Courts, and have been the grounds of a multitude of appeals to the Supreme Court. The doctrine can no longer be regarded as in the least degree unsettled. In a series of long and careful decisions this Court has examined these questions in every aspect and has set forth in succinct form the rules applicable thereto. To aver (as the petitioners do), as a reason for this Court's interference that "This honorable Court has never yet in any case directly passed upon the questions constituting the distinguishing features of this case and controlling its correct de cision," is virtually to ask this Court to assume appellate jurisdiction in every instance where a claim is advanced under the shelter of *Fosdick* vs. *Schall ;* for it would be difficult to conceive of such a claim which might not possibly be distinguished from those already brought to the attention of the Court, and for which, therefore, the

claimants might not assert some distinguishing feature as a ground for the Supreme Court's jurisdiction.

It is claimed by the petitioners in paragraph XXIX of their petition that the decision of the Circuit Court of Appeals for the Fourth Circuit, in a case entitled *Southern Railway Company* vs. *Carnegie Steel Company*, 76 Fed. Rep., 492, conflicts with and is in diametrical opposition to the decision of the Circuit Court of Appeals for the Fifth Circuit in the present cause, and that therefore the intervention of this Court is necessary in order to maintain a uniformity of jurisprudence between the different Circuit Courts of Appeals.

We submit, however, that the petitioners have misconstrued the remarks which the Supreme Court has made to the effect that a writ of *certiorari* will be granted where it is necessary to avoid a diversity of judgments. We think that a reference to the opinions of the Circuit Court of Appeals for the Fourth Circuit in the Carnegie Steel Company case, and of the Circuit Court of Appeals for the Fifth Circuit in this cause, will not disclose any different understanding by these two Courts of the principles that govern in such controversies. Both Courts carefully reviewed the decisions, particularly those of the Supreme Court, and applied the same doctrine to the respective state of facts before them. The claim in the one case was allowed and in the other denied ; but that difference in result does not present a diversity of judgment which casts upon the Supreme Court the burden of review. The infinitely varying conditions which surround claims of intervenors in foreclosure suits will always give rise to differences in the application of the principles laid down by the Supreme Court. Even if this Court should issue the writ prayed for and, upon the

return of the writ, should reverse the decision of the Circuit Court of Appeals, it will not be pretended that Courts would never in the future deny a priority to those who had supplied steel rails to mortgaged railroads. The reason is that the diversity of judgment in this cause and the Carnegie Steel Company cause is not a diversity of *law*, but of *fact*, and that as long as the transactions of men differ there must necessarily be differences in the decisions of Courts of justice.

Upon the point suggested in paragraph XXVIII of the petition as the second important question of law involved in the cause, we have only to say that the matter there referred to falls largely within the arguments above suggested. Furthermore, that matter rested upon questions of fact as to the existence of any revenues in the hands of the Receiver peculiarly applicable to the payment of such claims as that of the petitioners, and the diversion of any such revenues to the use and for the benefit of the holders of the bonds secured by the mortgage foreclosed in this cause. These questions of fact must be treated as having been settled in the lower Courts adversely to the petitioners, and the Supreme Court cannot be asked to go into them now. It may be said in passing, however, that the attempt on the part of these petitioners to spell out a prior lien upon the revenues in the hands of the Receivers, being necessarily dependent upon the diversion to the benefit of the bondholders of current income applicable to the payment of petitioners' claim, it was primarily incumbent upon the petitioners to show that some such income was diverted. Far from showing this, however, they admit in the sixth paragraph of their petition that the receivership of the property in question did not arise until *nine months* after the last of the

rails supplied by them had been delivered to the railroad company. During all of this period (within which, if ever, the current income applicable to the payment of their claim must have arisen) the petitioners failed to enforce their claim, or to assert their right to any portion of the current income. On the contrary, as appears by the first and second paragraphs of the petition, they expressly waived any such right by taking notes, and renewals of notes, from the railroad company in lieu of payment, thus showing that they did not expect the current income to be applied to their use. And the last of the notes so taken matured subsequently to the appointment of the Receivers. Where, then, can the petitioners point to a diversion of income upon which to found a right to receivership revenues?

They state in paragraph XXVIII that the question here is whether a mortgagee has any lien upon the revenues of the mortgaged property accruing prior to the filing of a foreclosure bill, and during a receivership provoked by others; but, whatever view the Court might take of that point, the real question (if any there were), would be, not as to the lien of the *mortgagee*, but as to the lien of the *petitioners*. Their case must rest upon their own title, and not upon any alleged defects of the mortgagee's title.

For these reasons we submit that the petition for a writ of *certiorari* should be denied. We append hereto a copy of the brief which we filed in the lower Court.

HERBERT B. TURNER,
Of Counsel for the Respondent.

MARTIN B. BROWN, Printer and Stationer, 49 to 57 Park Place, N. Y.

IN THE CIRCUIT COURT OF THE UNITED STATES,

FOR THE EASTERN DISTRICT OF TEXAS, AT GALVESTON.

THE FARMERS' LOAN AND TRUST COMPANY, Trustee, Complainant, *vs.* HOUSTON & TEXAS CENTRAL RAILWAY COMPANY, *et al.*, Defendants.	No. 227 Eq.

Interventions of the Lackawanna Iron & Coal Company, the Southern Development Company and the Morgan's Louisiana & Texas Railroad and Steamship Company.

Argument for the complainant in opposition to said interventions.

LACKAWANNA CASE.

Petition avers that under contracts of December 28, 1882, April 26, 1883, and of October 30, 1883, petitioner delivered to the Houston & Texas Central Railway Company about 18,000 tons of steel rails, and took therefor certain promissory notes of the Company, some of which were paid and some of which were extended; that all of said notes or extensions thereof were dated on or prior to December,

1884, and were past due at the time of the filing of the intervention herein, which was November 3, 1891. That said rails had been used in the betterment of the road, and were absolutely necessary, and alleges that the indebtedness was contracted by it in consideration of its promise to pay the same out of the earnings of its railway, and that they were furnished with the expectation and belief that they would be paid for out of the revenue and earnings. That the Houston & Texas Central Railway, with its branches, was placed in the hands of receivers on or about the 21st of February, 1885, and that when the bill was filed in this cause on the 6th of April, 1889, upon the first mortgage bonds, the receivership was extended in this cause; that a considerable portion of said rails (amount not given) was used upon the Waco & Northwestern Division, and that the intervention seeks to have the proportionate amount paid out of the earnings in the hands of the Receiver, or failing in that, out of the proceeds of sale.

The petition alleges that the Southern Development Company had brought suit upon a similar claim in the Federal Court in Equity Cause No. 185, to which general and special demurrers were filed and sustained by the Court and the bill dismissed without prejudice.

The contracts set out in the petition were referred to as part of the petition.

In his report filed herein on the 13th of January, 1896, the Master finds that negotiable promissory notes were given by the defendant company for all rails sold under the three contracts; that all of said sales were made on a stated credit for a fixed period of time, viz., six months after the average date of each delivery, and that said defendant company (the H. & T. C. Railway Company) had the right under said contracts to extend the time six months longer from the maturity of said notes; that such extensions were made for the accommodation and to suit the convenience of said defendant company, and that the said extended negotiable notes remaining unpaid matured in the months of February, March, April and May, 1885.

That all of the rails delivered under the first contract, and about one-half of the rails delivered under the second contract, were paid by the railway company prior to the appointment of any receiver of said property; but that the remaining half under the second contract and all rails furnished under the third contract are not paid for.

That the rails furnished under the second contract were furnished under a contract made a year and ten months prior to the appointment of the receiver in Cause No. 185, and about three years and three months prior to the appointment of the receiver in Consolidated Cause No. 198, and about six years prior to the appointment of the receiver in this cause.

That the rails furnished under the third contract were furnished under a contract made about sixteen months prior to the receivership in Cause No. 185, and about two years and nine months prior to the receivership in Consolidated Cause No. 198, and about five years and six months prior to the appointment of the receiver in this cause.

He further finds as follows: "I find that the debt for which the Lackawanna Company claims payment in its petition herein cannot be classed as a current debt made in the ordinary course of business, as those terms seem generally to be understood, yet it appears that when the contracts hereinbefore mentioned were entered into between the said Lackawanna Company and the defendant railway company the condition of the track of the defendant railway company was such that the demand for new rails upon the most worn portions of the roadway was practically imperative."

And further, "I find that when the aforesaid contracts were made with the said Lackawanna Company, both seller and buyer expected the debts to be paid from the net income of the property; that the credit extended under said contracts was at the request of and for the accommodation of the defendant railway company, and upon its

general credit. That such sales were made without any stipulation that security should be given by the defendant company for said rails, or that payment therefor should be made out of any particular fund, or in any particular way; that said sales were for an unusually large amount of rails, and the defendant was unable to pay cash therefor, and there was no way of obtaining said rails except upon a credit; and petitioner herein, at the time of said contracts and sales, had knowledge of the mortgage of June 16, 1873, given by the defendant company upon the properties of its Waco & Northwestern Division to secure the first mortgage bonds, which said mortgage has been herein foreclosed."

SOUTHERN DEVELOPMENT COMPANY CASE.

Petition alleges that the petitioner advanced to the H. & T. C R'y Co. a large amount of money for moneys advanced by it to the defendant company to enable it to pay for supplies, labor, repairs, operating and managing expenses, proper equipment, useful improvement and other necessary expenses of its railway, by which defendant's railway had been kept in safe and running order. The dates of the advances are not given. Petitioner alleges that it filed suit in the Federal Court at Galveston, cause No. 185, and that upon general and special demurrers being interposed same were sustained and the bill was dismissed without prejudice. It alleges that part of said advancements went to the benefit of the W. & N. W. Division, and seeks to recover the proportionate part in this case out of the earnings in the hands of the receiver, or from the proceeds of sale.

The Master finds that the money was *loaned* to the defendant company by the Southern Development Company and sums up the purposes for which it was used in general terms as follows: "I find that by the advances so made by petitioner to said defendant railway company the railways of said defendant company were kept in safer running order, and its property and business increased and rendered more valuable to the bondholders under the

mortgage described in the bill of complaint filed in this cause, as also to all other creditors of the defendant railway company; that said advances were so made to defendant railway company for the purposes aforesaid, and without them said company would not have been able to maintain its credit and meet its obligations, and that said advances were made in consideration of the promise of the defendant railway company to pay the same." The said advances were made between the 14th of July, 1884, and March 24, 1885.

MORGAN CASE.

Petition alleges an indebtedness on account of certain promissory notes, dated respectively in the years 1882, 1883 and 1884, for money loaned the H. & T. C. R'y Co. for improvement, equipment and betterment of its road, to purchase supplies, pay for labor, etc. Alleges the bringing of the suit by the Southern Development Company, No. 185, the interposition of demurrers, the sustaining of the same, the dismissal of the bill on the 27th of May, 1886, without prejudice. Alleges that the loans were made to the H. & T. C. R'y Co. in consideration of its promising to pay the same out of the earnings of its railway, and alleges an equitable lien superior in rank to the mortgage bonds and coupons. That a portion of said money was used for the benefit of the Waco & N. W. Division, and seeks to recover the proportionate part of said indebtedness out of the earnings in the hands of the receiver or out of the proceeds of sale.

The Master finds that between December 9, 1880, and the 26th of May, 1884, the defendant company executed and delivered to the Morgans' Louisiana and Texas Railroad and Steamship Company, intervenor, sundry promissory notes for moneys advanced to it by intervenor; and further finds as follows:

"I find that during the year 1884, and for several years prior thereto the finances of the defendant company were in an embarrassed condition, its expenses, in-

cluding fixed charges, interest, etc., exceeded its income for the year 1871, $670,839.14; 1882, $430,177.16; 1883, $570,979.25; 1884, $991,481.44; and it reasonably appears that without the advances made by petitioner as herein recited (constituting nearly one-third of its floating debt as it existed in 1884), it would not have been able to maintain its credit and meet its obligations.

"I find that by the advances so made by petitioner to said defendant railway company the railways of the defendant company were kept in safe running order and its property and business increased and rendered more valuable to the bondholders under the mortgage described in the bill of complaint filed in this cause, and also to all other creditors of the defendant railway company; that said advances were so made to defendant railway company for the purposes aforesaid, and that without them said company would not have been able to maintain its credit and meet its obligations, and that said advances were made in consideration of the promises of the defendant railway company to pay the same."

Argument.

It is submitted that the petitions for intervention do not make out a case of contract or statutory lien. We do not understand that this character of lien is seriously claimed, and the findings of the Master conclusively settle this question against the interventions. The laws of the State of Texas then in force permitted railroads to borrow money and to mortgage their property, but prescribed the mode and manner in which mortgages might be executed, and rendered them invalid unless such laws had been complied with. The Act of 1876, as given by articles in Sayles' Texas Civil Statutes, prescribes:

"Art. 4219—Right to borrow money, issue bonds, etc. —Such corporation shall have the right from time to time to borrow such sums of money as may be necessary for con-

structing, completing, improving, or operating its railway, and to issue and dispose of its bonds for any amount so borrowed, and to mortgage its corporate property and franchises to secure the payment of any debt contracted by such corporation for the purposes aforesaid.

"ART. 4220—Mortgage invalid unless, etc.—No mortgage by such corporation shall be valid unless authorized by a resolution adopted by a vote of two-thirds of all the stock of such company, after notice and in a manner provided in this title for increasing the capital stock of such corporation.

"ART. 4221—Resolution authorizing mortgage shall be recorded—When any such resolution has been adopted, in the manner provided by the preceding article, it shall be recorded in the office of the Secretary of State, and no such resolution shall take effect until so recorded."

The H. & T. C. Ry. Co. is a corporation created by and existing under the laws of the State of Texas, and is bound by all the provisions and restrictions of the General Railroad Act. No mortgage or lien can be created by contract unless in the mode prescribed by the statute, and there is no pretense that this has been done. The intervenors must, therefore, either stand upon the usual claim of equitable lien against the net earnings or upon some statutory lien. No statutory lien is shown by their petitions. The question arises, have they any equitable liens? Where one furnishes iron to be laid into a railroad and allows it to go into and become a part of the road, it is covered by such mortgage and he has no lien which can displace it.

G. H. & H. *vs.* Cowdrey, 11 Wall., 459.
N. O. & O. R. R. Co. *vs.* Mellen, 12 Wall., 362.

A railway mortgage upon present and future acquired property of a railway company, and its incomes and profits, is a prior lien only upon the net earnings of the road after the payment of all the operating expenses, where the road is in possession of the company.

Hale *vs.* Frost, 99 U. S., 389.

Section 584, of Jones on Corporate Bonds and Mortgages, says:

"It has sometimes been sought to establish equities in favor of those who have furnished material or money for completing or repairing of railroads, on the ground that the property has thus been conserved and rendered capable of a profitable use. This is, in fact, an attempt to apply to railroads the principle adopted by the civil and maritime laws of awarding priority to the last creditors who furnish necessary supplies and repairs to a vessel. Thus, in Galveston, etc., R. R. *vs.* Cowdry, the person who had furnished the iron laid upon a portion of the road claimed therefor an equitable lien in preference to an existing mortgage: First, because the mortgage covered the iron only as future acquired property, and upon the principle of equitable estoppel, which should yield when it comes in conflict with a superior equity; and, secondly, because his property, applied to the road, had rendered it capable of being operated when it otherwise could not have been used. The Supreme Court of the United States denied the claim on both points, declaring that the mortgage attached to the property as soon as it was acquired, and that the principle of the maritime law contended for had no application."

The case of Blair *vs.* St. Louis, etc., R. R., 23 Fed. Rep., 521, held that an attorney was not entitled to a preference over the mortgage as regards money paid by him upon judgments against the railroad company and upon claims for wages and for stock killed, under an agreement that the amount so advanced should be repaid by the company though the payments were so made by him within six months before the payment of a receiver. He simply loaned the money to the railroad company without security. If he had taken a mortgage at the time of making the loan he could not have claimed priority of payment over an existing mortgage.

Under the authority of 29 Fed. Rep., 561; 20 Fed. Rep., 260; 33 Fed. Rep., 778; 22 Fed. Rep., 179; 22

Fed. Rep., 471, and 5 Fed. Rep., 846, the principle is adduced that the equitable lien in favor of creditors (even if one exists) who have furnished labor and supplies is not allowed to extend back for a longer period than six months, except under extraordinary circumstances. In fixing this period the Courts recognized the principle that the extent to which this class of claims has to run back is measured by the usual course of credit and business of the company in the conduct of its affairs—that is, the usual term of credit upon which companies have purchased their supplies, or settled, as in the case of railroads, with their connecting lines, is taken as the measure of the period within which this class of claims shall be protected.

We submit to the Court that no case is stated in any of the petitions for intervention giving the intervenors any standing or entitling them to any relief in a court of equity.

Jurisdiction in these cases must be founded, because the petitioners' claims are of that equitable character that gives them a standing for remedy and relief in a court of equity, or because of some special character of the defendant as a railway company, and such conditions and acts of the defendant shown in the petition as to entitle them to come into a court of equity for relief against the railroad company.

First—*As to the intervenors' claims.*

Not contesting at present the most equitable completion that can be desired for their claims—that is, for necessary indispensable supplies for the operation of the railroad contracted in good faith on the expectation of payment out of the current earnings at the time they accrued—it is, we believe, without example or precedent, that such claims have ever been the foundation of a proceeding in equity. They are mere debts, simple contract debts, not a lien or privilege affixed to anything for which remedy can be claimed in a chancery court. Until the decision of Fosdick *vs.* Schall, 99 U. S., in 1878, and the

contemporary and subsequent cases we hazard nothing in asserting that no lawyer ever dreamed of going into equity with such claims. It is not suggested in any treatise on equity, any book on liens, or contracts or receivers. In no case were they ever sustained. In Railway Co. *vs.* Cowdry, 11 Wall., 482, the Court, by Justice Bradley, had said: "As to the point of giving priority to the last creditor for aiding to conserve the thing, all that is necessary to say is, that the rule referred to has never been introduced into our laws except in maritime cases which stand on a particular reason."

And in recent years the United States Supreme Court has more than once repeated this statement that the doctrine of maritine liens cannot apply to railroads.

Thompson *vs.* Valley R. R. Co., 132 U. S., 68.

Fogg *vs.* Blair, 133 U. S., 534.

Toledo R. R. Co. *vs.* Hamilton, 134 U. S., 296.

In Trustees *vs.* R. R. Co., 2 Wood, 542, 1876, Justice Woods had said: "The fact that the floating debt was contracted in good faith for the benefit of the railroad company's property, and therefore for the benefit of the bondholders, is true perhaps of all such debts. But that does not give the floating debt creditors any ground upon which to claim that their debt should be paid first * * * To undertake to do it would be to invade the legal rights of the bondholders, and, if established, as within the power of a court of equity, would shake the credit of railroad securities throughout the world."

In Denison *vs.* R. R. Co., 4 Biss., 416, 1864, Judge Drummond said: "What equitable lien had these petitioners for materials furnished a railroad on that fund? None. Why? Because those who had prior liens came in and swept it away; and more than that had not been half paid. It is precisely like the case of a man who furnishes to the owner of a farm the means of carrying it on; but

there is another party who has a lien upon the farm, and it is sold and ordered that the party may be paid. Now the fact that the mechanic or laborer has furnished the means of carrying on the farm would not authorize him to come into a court of equity and cut off the prior lien which exists on the farm and prevent it from being paid. These parties ought to be paid. They have a just claim against the road, but it is against an insolvent corporation and they ask parties who have a prior right and lien to pay them because those with whom they had dealt cannot."

High, on Receivers, sec. 394*a*, lays down the rule that mere contract debts of a railway company as for labor, materials and supplies incurred prior to the appointment of the receiver, and unsecured by any lien upon the property, cannot be given priority over antecedent mortgages; and the proposition that such contract debts can through the aid of a court of equity be given such priority seems to be a proposition wholly indefensible upon sound reasoning.

The present petitions are an experiment at a novel, unjust and unauthorized extension and perversion of the doctrine of Fosdick *vs.* Schall, and kindred cases, to go far beyond the principles of those decisions, and in fact to revolutionize the primary elements and most settled doctrines of equity jurisprudence and practice.

The principle of Fosdick *vs.* Schall is clear and it is this: It was a suit by the mortgagee, in which he applied for and obtained a receiver, a condition of which, imposed by the Court at the appointing of the receiver, was that the receiver should pay out of the current earnings all debts due and owing for labor and services rendered in operating the railroad within the last three months, and all indebtedness of engines, iron, wood, supplies, cars or other property purchased within the said period of three months for the use of the company. Certain cars were used by the road prior and subsequent to the appointment of the receiver, and for rent for the use of the cars prior to the

appointment of the receiver. Schall claimed priority to the mortgage out of the proceeds of the sale of the mortgaged property. The Supreme Court rejected his claim, and we shall have further occasion to compare this claim to the claims of the intervenors when we come to define the precise character of the latter; but the Chief Justice took occasion to lay down the doctrines on which allowances could be rightfully made out of the earnings in the receiver's hands, or out of the proceeds of the sale of the mortgaged property. This opinion was evidently made on great consideration, and has been since repeatedly recognized by the Court. We only seek at present to ascertain from the case the exact nature of the legal right or claim of those creditors for necessary materials who are declared entitled to preference by the Court. It held that, even though the mortgage may in terms give a lien on the profits and income, until possession is actually taken, or something equivalent done, the whole earnings belong to the company and are subject to its control. That the mortgagee has strict rights which he may enforce in an ordinary way. If he asks no favors he need grant none; but if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. Such application always calls for the exercise of judicial discretion, and the Chancellor should so mould his order that, while favoring one, injustice is not done to another. If this cannot be accomplished the application should, ordinarily, be denied; also, that if no such order is made when the receiver is appointed, and it appears from the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made out of the earnings, which ought in equity to have been employed to keep down debts for labor, supplies and the like, it is within the power of the Court to use the income of receiverships to discharge obligations which, but for the diversion of the fund, would

have been paid in the ordinary course of business. This not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if they give to one class of creditors that which properly belongs to another the Court may, upon an adjustment of account, so use the income which comes into his own hands as if practicable to restore the parties to their original equitable rights.

Here is expressed positive determination that the creditors for necessary supplies have no lien on the mortgaged property or on the earnings; that the earnings, until possession, obtained of them by the mortgagee, in accordance with his strict legal right, notwithstanding the mortgage lien, "belong to the company, and are under its control." The company is, in a sense, a trustee of all creditors and stockholders to act fairly and equitably with its earnings. If, in the right of the mortgage, he obtains a receiver, the Court, as the condition of the favor of the equity it extends to him, will compel equity to be done to the current-fund creditors.

Now nothing can be less doubtful than that the Court lays down no possible doctrine from which it can be justly argued that the current-fund creditor has any lien in law, and it is obvious that he meant equity law, not law as contradistinguished from equity, authorizing him to proceed against the earnings of the *corpus* of the property. No one could have said more plainly than the Chief Justice, if he had wanted to, that the current earnings creditor has a prior lien to the mortgage creditor, and is entitled for its enforcement to the same remedy in equity that the mortgage creditor possesses for his lien. If such had been the principle, the theory, the philosophy of the opinion, so carefully matured and expressed, and intended for precedent, it would have been made clear; but, instead of this, and to the reverse of this, the nature of the right of the current-earnings creditor is most carefully

guarded by "sound judicial discretion, which may, under the circumstances of the particular case, appear to be reasonable"; an equity growing out of the doing of equity, in order to get equity by the mortgagee, dependent upon the most general "sense" of "trust" in which the officers of a corporation are trustees for all its creditors and stockholders.

The mortgagee has his entrance into equity by virtue of his mortgage. The mere simple contract creditor never had, and has not now, any standing to go into a court of equity. This doctrine is too elementary to require discussion or authority; otherwise all distinction between law and equity as to railroads would be obliterated.

The case of Express Company *vs.* Railroad Company, 99 U. S., 191, decided at the same term as Fosdick *vs.* Schall, throws the strongest light on this branch of the case. The Express Company advanced $20,000 to the railroad company to be expended in repairing and equipping its railroad, for which it was to have certain express facilities, accounts to be made monthly, and to continue for a year, and until payment of the $20,000. The railroad company then executed a deed of trust to secure mortgage bonds, and foreclosure suit was brought and a receiver appointed. The receiver refused to complete the contract, and the Express Company sued in equity for its performance, which, of course, involved compensation therefor. Mr. Justice Swayne said: "The appellant has no lien. * * * As well might the receiver be decreed to satisfy the appellant's demand by money as by the service sought to be enforced. Both belong to the lienholders and neither can be thus divested. The appellant therefore can have no *locus standi* in a court of equity. Both those objections appear by its own showing. It was therefore competent for the court below *sua sponte* to dismiss the bill for want of equity apparent on its face."

Hale *vs.* Frost, 99 U. S., 389, decided by the Chief Justice at same term, was a case where the mortgagee, after default of two years on interest, obtained a receiver, who

made net earnings over and above all operating expenses, and the question was payment out of those earnings to the mortgagee, or to an intervenor for supplies for machinery to the company, which went into the possession and use of the receiver. The ruling is that the net earnings made by the receiver are not necessarily the property of the mortgagee, but are subject to the disposal of the Chancellor in the payment of claims which have superior equities, which that of the intervenor had in that case.

Turner *vs.* Railway Company, 8 Biss., 315, decided in October, 1878, by Judge Drummond, was a review of the rulings of his circuit on this class of claims, after the fullest argument, and immediately preceded Fosdick *vs.* Schall, and laid down the law in identical terms. The Judge said: "During the discussions which have taken place on this subject, the allowance of these back claims has been sometimes called a lien, but in point of fact it never has been nor can it be justly so called, but, as already stated, is an exercise of the equitable power of the court in the premises."

Miltenberger *vs.* Railroad, 106 U. S., 286, decided in 1882 by Justice Blatchford, was a case where default on the first mortgage occurred November, 1873, on the second mortgage January, 1874, and suit for foreclosure brought by the mortgagee August, 1874. A receiver was appointed, with directions to pay the arrears due for operating expenses incurred within ninety days, and to pay not exceeding ten thousand dollars to competing lines and for materials and for repairs and ticket and freight balances; also to make certain improvements and purchases, and this was sustained.

The question at once suggests itself, why limit the amount to ten thousand dollars, or the time to ninety days, if such claims have a legal standing constituting right or cause of action? A few extracts from the opinion will show how variant was the principle on which the Court proceeded from the idea of the existence of any such right or ground of action:

"It cannot be affirmed that no item which accrued before the appointment of a receiver can be allowed in any case. Many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property for the receiver to pay pre-existing debts of certain classes out of the earnings of the receivership, or even the *corpus* of the property, under the order of the Court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands *prima facie* on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by special circumstances. It is easy to see that the payment of unpaid debts for operating expenses, accrued within the ninety days, due by a railroad company suddenly deprived of the control of its property, due to operatives in its employ, whose cessation from work simultaneously is to be deprecated in the interests both of the property and of the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs, for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result in case of non-payment, the general consequence, involving also largely the interests and accommodations of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense by maintaining the good will and integrity of the enterprise, and entitle them to be made a first lien."

It is clear that no idea was in the mind of the Court that those claims or any of them, prior to the receivership, when they accrued by virtue of any contract right, or of their own inherent, legal or equitable force, were liens upon the property, or could have judicial standing to be asserted as such. They were claims, debts, which from the beneficial effect of so doing, in preserving the railroad property, advancing the success or interests of the receivership, it became equitable, with reference to the receivership itself, to pay, and therefore the Court gave

them priority of payment. The term lien is alone used as the result of the priority allowed by the Court under the special circumstances of the receivership. If they possessed legal standing, why limit the aggregate allowance of them to the arbitrary amount of ten thousand dollars or to the period of ninety days? The receiver had put the payment of this class of claims on the ground that "it was indispensable to the business of the road, and unless authorized to provide for them at once the business of the road would suffer great detriment. These reasons were satisfactory to the Court." Some of the claims were expressly disallowed although "the creditors threatened not to furnish any more supplies on credit unless they were paid the arrears," and the court says "the action sanctioned by the Court in allowing claims within the scope of the order of the Court appears to have been careful, discriminating and judicial."

When a mortgagee, entitled to relief in equity, solicits or obtains the appointment of a receiver, the judicial wisdom and necessity of considering all the equity and policy as respects the interests of the receivership and the principles of justice of the payment of any particular claim, is apparent. The situation furnishes its own reasons and its own law. But that the holder of a claim, not in itself a lien, not of its own right entitled to any standing in a court of equity, can be permitted to force its way into equity, obtain a receiver, and then make the receivership furnish the ground of the equity of his claim, seems to us extremely absurd.

The Trust Company *vs.* Souter, 107 U. S., 591, arose where default was made on the mortgage interest October 1, 1873, and semi-annually thereafter. December 6, 1879, the mortgagee filed bill of foreclosure and obtained a receiver, the order for which required the receiver to pay and discharge all amounts due and owing for labor or supplies accrued in the operation and maintenance of the road within six months immediately preceding. The net earnings of the receivership exceeded $200,000, which with the assent of the mortgagee was expended in pur-

chasing additional grounds and rolling-stock and making permanent improvements of the railroad, all of which was embraced in the sale, leaving about $65,000 of debts unpaid, of the character which the Receiver had been ordered to pay, and the question was upon their right to payment out of the proceeds of sale. The Chief Justice said that their right to such payment is decided by Fosdick *vs.* Schall and Miltenberger *vs.* Railroad Company. The principle of the decision as applied to the particular case ought to be quoted:

"Prior to the appointment of the receiver the gross earnings do not appear to have been enough to pay expenses, but afterward they yielded a considerable surplus. There cannot be any doubt that it was to the interest of the bondholders that the road should be kept in operation, and as they did not see fit to take possession while it could only be operated at a loss, it certainly was not an abuse of judicial discretion for the Court to order, as a condition of granting their application for a receiver, that the debts incurred by the company in thus protecting their security should be paid from the income of the receivership if in consequence of an increase of revenue it could be done."

It was then held that, as those net earnings, instead of being applied to pay the debts as directed, were, by the request of the mortgagee, diverted to add to the value of the mortgaged property, afterward sold, with no intention of the Court to revoke the original order, the proceeds of sale would, in equity, be held to represent the fund directed to be applied to the labor and supply creditors when the receiver was appointed.

Burnham *vs.* Bowen, 111 U. S., 776, decided by the Chief Justice—Mortgage executed June 1, 1871, to secure bonds for $4,125,000; no interest was ever paid, the company remaining in possession and operating the road until 1875, when a suit for foreclosure was commenced, a receiver was appointed, and the receivership earned over $25,000 of net earnings. All of which, together with the

railroad, went into the hands of the mortgagee, by strict foreclosure, but subject to the claim of Bowen, amounting to $6,515.42 for coal sold to the railroad company in 1874—"one of the current debts for operating expenses, made in the ordinary course of a continuing business, to be paid out of the current earnings," and there was no other liability on account of current expenses unprovided for when the receiver took possession, and this claim would have been paid out of current earnings, at maturity, had the Court not interfered, at the instance of the trustees, for the protection of the mortgage creditors.

Out of his earnings the receiver had paid $7,898, a debt for real estate for the company, and nearly $18,000 for right of way. The court held that the right of Bowen for payment out of the earnings by the receiver, was within the principle of Fosdick *vs.* Schall, those earnings having been diverted to payment for additional property to increase the security of the mortgage debt. But the opinion declares: "We do not now hold any more than we did in Fosdick *vs.* Schall, or Huidekoper *vs.* Locomotive Works, 99 U. S., 258, 260, that the income of a railroad, in the hands of a receiver for the benefit of mortgage creditors who have a lien upon it under their mortgage, can be taken away from them and used to pay the general creditors of the road. All we then decided, and all we now decide, is, that if current earnings are used for the benefit of mortgage creditors, before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."

These decisions by the Supreme Court of the United States seem to us to leave no ground to doubt that the claim of a creditor for supplies, etc., admitted in the fullest sense to come within the class specified by Chief Justice Waite of "Current Income creditors," has no such lien within the purview of equity law as entitles him to a standing in a court of equity by original suit for its assertion and enforcement.

In Coe *vs.* Railroad Company, 31 N. J. Eq., 105, the Court thus construes Fosdick *vs.* Schall: "The grounds on which the decision rests are the power of the Court to do equity, in the imposition of equitable terms, at the time when its aid is invoked by the mortgagee for the realization of the money due him on his security."

In F. L. & T. Co. *vs.* M. & R. Co., 21 Fed. R., 261, the nature and right to the relief is clearly shown by Love, D. J.: "It is not necessary to the right of intervention to participate in a trust fund, in *custodia legis*, that the intervenor should first obtain a judgment at law, or that he should have any lien upon the fund."

In Douglass *vs.* Cline, 12 Bush's Ky. R., 608, the claim of employee, etc., on current earnings, is placed within the equitable control and discretion of the Court as to such earnings.

In Dow *vs.* R. R. Co., 20 Fed. Rep, 260, 188, an able Federal Judge, while giving the fullest weight to the principles of the Supreme Court decisions, and providing, in the appointment of a receiver on the application of the mortgage creditor, for payment of the labor and material creditors, in a case in which there had been delay of a year by the mortgagee to apply for a receiver, uses this language: "It is no answer to say that the company used its earnings for other purposes. The bondholders knew such liabilities must be incurred in running the road. They had it in their power to take possession of the road and secure its earnings and pay such liabilities. The class of persons protected by this order could not do anything to protect themselves, or compel a different application of the earnings."

Why not? Why could not these current-fund creditors do anything to protect themselves, or be heard, as to the application of the earnings? Because they had no lien upon the earnings, no right of action or suit which attached to or fixed itself upon them. No standing to go into a court of equity and say that these earnings were

mortgaged, hypothecated, pledged to them; that they had any form or manner of privilege or hold thereto, or thereon, for which they could ask the relief or decree of a court. It did not enter into the remotest imagination of the careful and able Judge, in giving the utmost latitude to the letter and spirit of the decisions of the Supreme Court on this subject, that the current-fund creditors had not only a right of action to come into a court of equity and assert a superior paramount lien on the earnings, but, far beyond this, to obtain the helping hand of the Court through its extraordinary and powerful instrumentality to take possession of the road and all its property, sequestrate all earnings on hand, use and apply future earnings indefinitely, repair, reconstruct, renovate the tracks, lay steel rails, build bridges, construct round-houses, etc., and all for the purpose of making earnings so as to create and make priority of payment to the current fund creditors.

Another case in which an able Federal Judge has endeavored to define the nature and status of the claims of the creditors preferred for payment out of the earnings on the appointment of a mortgagee receivership will throw additional light upon this question.

Blair *vs.* Railway Company, 22 Fed. Rep., 471, November, 1884, Judge Brewer said:

"What claims are entitled to such equitable preference? The Master has reported in favor of all claims accruing since the default in payment of interest on the mortgage debt—a period of over two years. This seems to proceed upon the assumption that the mortgagees, failing to take action, have made the mortgagor company their agent to incur debts—have impliedly consented that all such debts shall take preference of their secured claims. I do not think that this principle is sound. There is no implied agency to that extent, and I do not think that the rulings of the Supreme Court are based upon any such doctrine. The idea which underlies them I take to be this: That the management of a large business like that of a railroad company cannot be conducted on a cash basis. Temporary credit

in the nature of things is indispensable. Its employees cannot be paid every month. It cannot settle with other roads its traffic balances every day. Time to adjust and settle these matters is indispensable. Because in the nature of things this is so such temporary credits must be taken as assented to by the mortgagees, because both the mortgagees and the public are interested in keeping up the road and having it preserved as a going concern; and whatever is necessary to accomplish this result must be taken as assented to by the mortgagees. In this view, such temporary credit accruing prior to the appointment of the Receiver must be recognized by the mortgagees and the claims preferred. Now, for what time prior to the appointment of a receiver may these claims be sustained? There is no arbitrary time prescribed, and it should only be such reasonable time as in the nature of things and in the ordinary course of business would be sufficient to have such claims settled and paid. Six months is the longest time I have noticed as given. Ordinarily I think this is ample. Perhaps in some large concerns with extensive lines of road, and a complicated business, a longer time might be necessary. Certainly so far as the present road is concerned six months is ample. If any person permits a claim to continue a longer time than that he certainly has no right to be considered other than a general creditor with no preference on a secured debt. * * * Out of what shall these claims be paid? Primarily, of course, out of the earnings of the road, and ordinarily out of such earnings alone. * * * This is fair, because if no receiver were appointed and the claimants attempted by legal process to enforce the collection of their claims they could obtain no priority over the mortgages, but must still be subject to such mortgages. So that the appointment of a receiver ought not to give them a priority which they had not before."

He says that cases may arise in which such claims should be made a lien on the corpus of the property, but this is only in exceptional cases, and on special equity which must be shown.

The nature of this class of creditors is thus distinctly shown by Judge Brewer to be merely a simple contract debt, on credit, to be paid out of the earnings promptly in the ordinary course of the business of the company. The mortgagee, whose debt is in default, impliedly assents to such payment, and if the mortgagee obtains a receivership before the ordinary and proper time for such payment had elapsed, if to be made in due course of business, the Court, out of the net earnings of the receivership, should make the payment. But such debts standing beyond the period in which there was sufficient opportunity for payment out of the current earnings, if the current earnings had been adequate and so applied, are general debts, alone, with no equitable claim to any preference whatever.

The entire want of any character of lien to become the foundation of a suit in equity, as against the earnings, or the corpus of the property, of the claims which are the foundation of the petitions of the intervenors, is manifest from the entire body of decisions on this subject, and is expressly shown wherever the true equitable nature and status of such claims has received any definition at the hands of a court. It has never been asserted by any judge or in any book.

The argument heretofore has proceeded upon a line showing that the claims propounded by the intervenors would have no foundation in equity if original bills had been brought upon them.

In the next place, we submit that the claims of the intervenors are not of a character which under a receivership obtained by the mortgagees would entitle them to any equitable preference, but they are of the direct contrary character, and are wholly without equity.

The petitioners do not show the intervenors to be creditors within any period of time giving them preference.

It is to be observed that in Fosdick *vs.* Schall the order appointing the Receiver required payment of all debts for

labor, supplies, engines, iron, cars, etc., incurred within three months before the appointment. In Miltenberger *vs.* Railway Company it was limited to payment for arrears of operating expenses and for other classes of debts not exceeding ten thousand dollars accrued within ninety days. In Union Trust Company *vs.* Souter, to six months preceding the appointment of the receiver. In Burnham *vs.* Bowen there was but a single debt contracted but a short time before the receivership and which would have been paid at the day by the company but for the receivership. In Trust Company *vs.* Midland Company payments were limited to six months before the appointment of receiver. The language and reasoning of the Court is to be applied to the state of facts here existing. We submit that the correct analysis of them has been made and the true principle deduced by Judge Brewer in 22 Fed. Rep., from which we have already quite fully quoted. That is the true import of the language of the Chief Justice in Burnham *vs* Bowen, 111 U. S., 783: "We do not now hold any more than we did in Fosdick *vs.* Schall or Heidekoper *vs.* Locomotive Works, 99 U. S., 258, that the income of a railroad in the hands of a receiver for the benefit of mortgage creditors who have a lien upon it under their mortgage can be taken away from them and used to pay the general creditors of the road. All we then decided, and all we now decide, is that if current earnings are used for the benefit of mortgage creditors before current expenses are paid the mortgage security is chargeable, in equity, with the restoration of the fund which has been thus improperly applied to their use."

That is to say; the only case which can arise against the mortgagees is as to current expenses and current earnings. Not old debts contracted months or years ago for then current expenses. The soundness is manifest of the observation of Mr. Justice Wood, 2 Woods, 542: "The fact that the floating debt was contracted in good faith for the benefit of the company's property, and therefore for the benefit of the bondholders, is true perhaps of all such debts." It is scarcely conceivable otherwise. Its general debts must

be of that character or they would be ultra vires and illegal. But it is a debt current when the receiver is appointed to which alone the equity attaches.

In Barry *vs.* Railway Company, 27 Fed. Rep., 1, Judge Wallace held, where a mortgage was given for the payment of semi-annual interest out of the net earnings of the railroad, that the expenses defrayed or incurred in producing earnings for a given interest period are the only charges that can enter into the income accounts for that period, except payment of interest on prior incumbrances; and that indebtedness contracted prior to such interest period cannot be charged against its net earnings so as to prevent the mortgagee from claiming his interest.

The debt of the Lackawanna Company was simply a contract debt for steel rails furnished to the Houston and Texas Central Railway at a given price per ton, for which the railway company was to give its notes at six months, with a privilege of extension of an additional six months. Not a word said in the contract how the debt was to be paid. Nothing said in the contracts about the earnings or any attempted lien thereon. Only a finding that the parties expected the notes at the dates of their last maturity to be paid out of the earnings. The other two cases are for money loaned upon the credit of the railway company to keep it a going concern. The debts contracted more than twelve months before the Central Railway with its branches was placed in the hands of a Receiver in the original cause of the Southern Development Company, and nearly six years before the bill was filed in this cause and the receivership extended thereunder. According to our understanding there is not a single fact which would bring them within the purview of the principle announced in Fosdick *vs.* Schall, even with that principle extended to the most radical extreme. The Lackawanna Company sells rails to the Houston and Texas Central Railway upon a credit of six months, with the privilege of extension for six months longer. The Southern Development Company, being a California corporation, lends money to a Texas railroad company to buy its supplies, etc., and upon similar

facts the Morgan Company files its petition. And for these they claim a lien superior to the mortgagees as against the net earnings and corpus of the property.

Preference of payment in Fosdick *vs.* Schall, was given to debts due and owing for labor and services rendered in operating the railroad and for engines, wood, supplies, cars, or other property purchased within three months and the class of debts to which the Court attributes the implied agreement of the mortgagee for preference is the current debts made in the ordinary course of business. In the Miltenberger case the order to the Receiver was to pay arrears due for operating expenses within ninety days and indebtedness not exceeding ten thousand dollars for materials and repairs, ticket and passage balances, and to connecting lines within ninety days. In the Souther case it was for coal which would have been paid for when due but for the receivership. This is the class of indebtedness upon which the equity allowed by the court against mortgagees arises. It is limited to such cases and not to be extended to others not within the same reason and policy.

In Fosdick *vs.* Schall certain railroad cars were purchased conditionally by the railroad and used by the company six months before and also during the receivership. The Supreme Court allowed for the use during the receivership, but decided that the prior rent for use of the cars constituted no equitable claim against the *prima facie* right of the mortgagees.

In the Huidekoper case, certain locomotives were sold to the railroad company to be paid for at stated periods, title to be in the vendor until payment made. The Court gave the Receiver authority to return the engines and to adjust, settle and pay for their use during the receivership. The Master reported an amount for that payment. The Court said: "The railroad company contracted to buy the engines and pay a certain price. The locomotive company retained a paramount lien to secure the sum so to be paid. The debt so incurred was not paid. The lien has been in effect foreclosed, and the balance of the debt

still remains due. Whatever may have been the form, this is the substance of the transaction. No equitable claim upon any fund in Court has been established as security for this debt. The locomotive occupies the position of a general creditor with no special equities in its favor."

In Hale *vs.* Frost, 99 U. S., 389, preference was allowed to so much of a claim as was for supplies for machinery but was rejected for materials for construction.

In Express Company *vs.* Railroad Company, 99 U. S., the former loaned the latter $20,000, to be expended in repairs and equipments for said road and the Supreme Court decided that there was no standing in equity for the balance of this sum due.

In 8 Bissell, 315, in which Judge Drummond defines the equitable discretion of the Court in dealing with property of the peculiar character of a railroad, it is to require receivers to pay operatives and supply men.

Judge Caldwell, 20 Fed. Rep., 267, defines them as persons furnishing labor and supplies and material for the use of the road.

Judge Brown, 22 Fed. Rep., 471, says: Claims for labor and supplies.

In Douglas *vs.* Cline, 12 Bush, 608, a preference was for back pay to employees for wages.

In L. C. & N. Company *vs.* Railroad Company, 29 N. J. Eq., 252, the railroad being involved made a bargain with a contractor, who was to furnish it with labor and services on the railroad. The Court held that such contractor had no equity against the mortgagees.

In Catheron *vs.* Railroad Company, 14 Fed. Rep., the preference is for amounts due employees and for supplies and materials.

In re Kelly, 5 Fed. Rep., 846, money advanced by the Lackawanna Company to the railroad company for neces-

sary uses, increasing the security of the bondholders at the request of some of the bondholders, and whilst the company was in default on its interest, held not to give a preference over bondholders obtaining receivership.

In Blair *vs.* Railroad Company, 23 Fed. Rep., 521, Justice Brewer says: "The attorney of the road paid off sundry judgments rendered against it, paid certain claims for wages and for stock, and paid them under an arrangement between himself and the President of the Company that the money thus advanced by him should be repaid on the 1st of January, 1884. This was only a few weeks before the appointment of a Receiver, and his claim is, that having paid these liabilities of the company at its instance, under a contract by which repayment was to be made to him within less than six months before the appointment of a Receiver, such debt should be preferred to the mortgage; we do not think so. It simply amounts to this: He loaned the company so much money but the bondholders had loaned theirs long before and loaned it secured by a lien. If he had taken a mortgage at the time of making this loan and thus obtained a lien, no one would contend that he thereby obtained priority over the earlier loan. This is all this transaction amounts to. He loaned to such company but did not take a lien. Now he asks that not having taken a lien and having loaned the money a few weeks before the appointment of a Receiver that he should obtain priority over those who loaned money three or four years or more ago and then took a mortgage."

In Bridge Company *vs.* Douglas, 12 Bush, 673, money borrowed to pay interest on coupons held not entitled to payment out of earnings. It did not stand in the place or have the equities of the coupons themselves.

Bound *vs.* Railway Company, 58 Fed. Rep., 473, Oct. 4, 1893, steel rails to the amount of over $50,000 necessary for the maintenance of the road were purchased in April, 1888, by the railway company upon credit of eight months from the Luckawanna Iron and Coal Company.

This purchase was made 18 months prior to the appointment of a Receiver. The expectation and promise of the president of the railway company was that the purchase would be paid for out of the earnings of the railroad. This promise and expectation was not fulfilled and only a portion of the debt was paid, the notes for the balance being extended from time to time until the Receiver was appointed. During this interval in July, 1888, three months after the purchase of the steel rails, and before the first note matured the sum of over $33,000 was paid on account of interest to the second consolidated mortgage bondholders. The Chief Justice, acting as Circuit Justice, and Hughes and Morris, District Judges, composed the Court, the opinion being rendered by Judge Morris, who said: "The rule giving preference to current expenses incurred on the faith of the earnings of a railroad shortly before the appointment of a Receiver has never been carried so far. The debt of the Lackawanna Company was an ordinary merchandise debt, evidenced by notes which were renewed from time to time. * * * The railroad company being heavily mortgaged, all that any unsecured creditors had to look to for payment was the earnings. The immediate earnings, it is clear, the Lackawanna Company did not look to, as the sale was upon a credit of eight months. * * * The claim is quite different from those ordinary and necessary current expenses of operating railroads, contracted but a short time before a receivership, and which, by the sudden action of the Court in appointing a Receiver, are left unpaid." And in reference to the promise which the president of the railroad made to pay the debt out of the earnings, the Court said: "In the present case it is true that the promise was to pay out of the earnings, and it is also true that out of those earnings to the extent of the amount decreed to have priority interest was paid to the second mortgage bondholders: but it is also true that by granting a credit of eight months, and by extending that credit over a period amounting in all to eighteen months, the Lackawanna Company must have contemplated that the interest falling due on the mortgage bonds was to be kept paid out of the earnings,

so that the road could remain in the hands of the railway corporation." And the Court disallowed the priority of that claim over any of the mortgage bonds.

In the case of Kneeland *vs.* Trust Company 136 U. S., 89, the Supreme Court uses this language: "No one is bound to sell to a railroad company or to work for them, and whoever has dealings with a company whose property is mortgaged must be assumed to have dealt with it on the faith of its personal responsibility and not in expectation of subsequently displacing the priority of the mortgage lien. It is the exception and not the rule that such priority of liens can be displaced. We emphasize this fact of the sacredness of contract liens for the reason that there seems to be growing an idea that the Chancellor, in the exercise of his equitable powers, has unlimited discretion in this matter of the displacement of vested liens."

We close our citation of authorities upon this branch of the case by reference to Thomas *vs.* Car Company, 149 U. S., 95, in which the Supreme Court circumscribed the bounds within which an equity court should confine itself in allowing any unsecured claim to displace vested contract liens. Wages due employees, current operating expenses, current balances of ticket and freight money, arising from indispensable business relations, and similar current debts accruing within ninety days are recognized as among the limited class of claims which, in its discretion, the Court may allow to have priority. The Supreme Court held it was error to allow a claim for the rental of cars necessary to operate the road for six months prior to the receivership; and said: "The case of a corporation for the manufacture and sale of cars dealing with a railroad company, whose road is subject to a mortgage securing outstanding bonds is very different from that of workmen and employees, or those who furnish from day to day supplies necessary for the maintenance of the railroad; such a company must be regarded as contracting upon the responsibility of the railroad company, and not in reliance on the interposition of a court of equity."

We undertake to say, with absolute confidence, that no case can be produced in which any Chancellor appointing a receiver has included among the claims which he has specified for prior payment claims for money loaned to the railroad.

On the contrary, in the year 1890, the Supreme Court of the United States, deciding the case of Morgan's, etc., Company *vs.* Texas Central Railway Company (137 U. S., 171), must be taken as having set this question forever at rest. In that case the Texas Central Railway Company had executed two mortgages to the Farmers' Loan and Trust Company as Trustee in 1879 and 1881 respectively. In 1884, it had executed another mortgage to another Trustee. Default occurred under the first two mortgages in May, 1885. The Houston and Texas Central Railway Company, operating the Texas Central, had been making advances to the latter from time to time on a running account, and in November, 1884, took demand notes of the Texas Central Company for the amount of these advances, which notes were afterward pledged to the Morgan Company. The advances had been made for operating expenses, taxes, etc., but had been applied by the Texas Central Company to the payment of coupons upon its first mortgage bonds. In April, 1885, the Morgan Company brought suit and had a Receiver of the Texas Central Company appointed, amending its bill in May after default had been made in the mortgages, so as to make the mortgage Trustees parties and claiming priority for the notes of 1884. The Trustee answered and subsequently filed a cross-bill for foreclosure. The Court absolutely denied the priority of the Houston and Texas Central advances in accordance with the doctrines laid down in its prior decisions. The following remarks occur in the course of the opinion:

"If the advances can therefore be treated as having been specifically procured for, or specifically applied to the payment of interest on said bonds (although there is no evidence to that effect), still such payment would

afford no basis for the assertion of a preference as against the bondholders. * * *

The contention is wholly inadmissible that the bondholders, because they received what was due them, should be held to have assented to the running of the road at the risk of returning the money thus paid, if the Company by reason of unrealized expectations, on the part of those who made the advances, should ultimately turn out to be insolvent and unable to go on. * * *

The doctrine of Fosdick *vs.* Schall, 99 U. S., 235, is that a court of equity may make it a condition of the issue of an order for the appointment of a receiver, that certain outstanding debts of the Company shall be paid from the income that may be collected by the receiver, or from the proceeds of sale; that the property being in the hands of the Court for administration as a trust fund for the payment of incumbrances, the Court, in putting it in condition for sale, may, if needed recognize the claims of material-men and laborers, and some few others of a similar nature, accruing for a brief period prior to its intervention, where current earnings have been used by the Company to pay mortgage debt or improve the property, instead of to pay current expenses, under circumstances raising an equity for their restoration."

This case is but a reiteration of the principles established in the Court's preceding decisions. It holds that even had there been such a diversion of the income to the benefit of bondholders as would have entitled material-men to an equitable priority, yet a money-lender did not come within the class of preferred claimants. The case is marked by a disposition to narrow the field of these ever-increasing claims for priority. The Court attacks with considerable severity the attitude assumed by some under the supposed shelter of the Miltenberger case that the public nature of railroad corporations absolves them in some mysterious way from fulfilling their private obligations to the purchasers of their bonds.

"It is true," says the learned Chief Justice in his able opinion, "that a railroad company is a corporation

operating a public highway, but it does not follow that the discharge of its public releases it from amenability for its private obligations. If it cannot keep up and maintain its road in a suitable condition and perform the public services for which it was endowed with its faculties and franchises, it must give way to those who can. Its bonds cannot be confiscated because it lacks self-sustaining ability, to allow another corporation, which, for its own purposes, has kept a railroad in operation in the hands of the original company by enabling it to prevent those who would otherwise be entitled to take it, from doing so, a preference in reimbursement over the latter on the ground of superiority of equity, would be to permit the speculative action of third parties to defeat contract obligations, and to concede a power over the property of others which even governmental sovereignity cannot exercise without limitation. And if all these advances should be considered as applied in payment of the operating expenses only, upon the theory, where such was not literally the fact, that they supplied a deficit created by the payment of interest out of the gross earnings, the same remarks would be applicable."

In all the statutory lien laws which have been enacted in this country with reference to railroads, buildings of every kind, and agricultural liens, we undertake to say that none has ever given a lien for loans of money. The views of legislators and of judges on this subject have grown out of public policy, arising from the necessity of protection and justice to the class of persons mentioned in all the above decisions—laborers, employees, men who supply materials necessary to the actual daily use and consumption of the road. There is no such equity in behalf of the money lender. He needs no such protection. Almost a compulsory necessity binds the dealing of the employee and supply men with railroad companies. It is their daily business—subsistence dependent upon it—and credit for short periods essential to the daily transactions. Not so with the money lender. No such considerations compel him to lend his money to the railroad company. He stands at arms' length. He goes for his profit. Instead of being the victim of the subject of necessity he is a seeker-out for the necessity of others, and

obtains advantage from them. We appeal not to prejudice, but simply state facts, which courts are quickest to declare as inherent in the very essence of equity.

What could be more infinitely dangerous and disastrous than to recognize as preference claims loans of money to railroad companies? When an order is made to pay for labor and supplies received within a certain period, it explains itself, and involves the equity on which it is founded, and which the Court intends to protect. But if this should be extended to money lending to the railroad, for the general purpose of paying for labor, supplies, operating expenses, etc., all safeguard, all certainty and security are gone. As was said in 2 Woods, 542, that is the real character, perhaps, of all such debts.

We now come to consider the bill and the provisions of the mortgage under which the proceedings in this suit were instituted. The mortgage was dated in 1873, and while in the granting clause the earnings of the road are not specifically mentioned it is clearly inferable that the same are to be applied to the payment of the interest after default declared and possession taken. For convenience of reference we make the following quotation:

"And in case the said Houston and Texas Central Railway Company shall fail to pay the principal or any part thereof, or any installment of interest or any part thereof on any of the said bonds at any time when the same shall become due and payable according to the tenor thereof and for sixty days after having been demanded, it shall be competent for said Trustee, its successors or assigns, to enter upon the said railway and the premises and property herein conveyed, by its attorneys and agents, and take possession of the same, without let or hindrance of the said first party, and every part and parcel thereof, and the appurtenances, and appoint an agent to operate and manage the same and receive the revenue and income thereof, applying the said fund after deducting taxes, necessary expenses and counsel fees, to keep the same in good order and repair, and the surplus to pay the interest and princi-

pal of all bonds which may be due and outstanding and secured hereby *pro rata*, and thereafter to the payment of any contributions due to the sinking fund herein established. And upon the request of the holders of one-fifth in amount of the bonds so in default which may be at any time outstanding under this deed of trust, it shall be the duty of said second party, by its president or agent duly appointed in its behalf to enter upon and take actual possession with or without entry or foreclosure, of said railway and property herein described, and all and singular each and every part and parcel thereof, and assume its management until the arrears of both principal and interest be paid or the property sold as herein precribed, receiving the rents, revenues and income thereof and applying them in the same manner as above stated."

The bill was filed April 6, 1889, alleged default in payment of interest due on the 1st day of January, 1886, and of every installment which has fallen due since that day; alleges accelerated maturity of bonds, and seeks foreclosure and sale.

The property had been placed in the hands of receivers in Equity Causes Nos. 185 and 198; and on the date of the filing of the bill the same receiver was appointed in this cause and the receivership extended herein.

It will be borne in mind that after the receivership in Nos. 195 and 198 on the main line, including all of its divisions, the interest until the 1st day of January, 1886, was paid, when the default first occurred, and the *corpus* of the property was then in the custody of the court. Sixty days thereafter the Trustee had the right of entry, but it could not exercise that right because of the condition of the property. It filed its bill in April, 1889, when the receivership was extended in the present cause, but never for one moment during the interval had the Court released that custody. The final decree in this cause finds that a very large amount of interest was due at the date of its rendition. We claim that we are entitled to have the net earnings which accrued before the institution of this suit

applied to the payment of that interest. We think we have very conclusively shown that the net earnings which have accrued since that time belong to us and upon this latter proposition we think there can be no serious controversy. Otherwise our mortgage security would be seriously impaired. The contention that the intervenors are entitled to be paid out of the *corpus* of the property, in our opinion, is not entitled to serious consideration.

The nature of railroad bonds and their importance in the business and finances of the country are well recognized. Payment of interest gives them value, causes them to command good prices, to be sought after, to circulate freely; they are instruments of the very highest negotiability. The courts have been jealous of their protection against defenses of which notice could not be fully imputed to their holders. And yet the argument here is, that the purchaser of a railroad bond takes it subject to be docked in favor of floating debt creditors and the decree of an equity court giving a paramount lien on the *corpus* of their mortgage property in favor of all such floating debt creditors together with the further claim that they are entitled to all of the net earnings. Mortal ingenuity could not stamp such securities with greater confusion, distrust and ruin. The purchaser of each bond would be at the peril of an *ex post facto* equity suit to determine the floating debt in existence. We contend that no court has ever so decided. It is impossible in the very nature of right and wrong.

M. F. Mott,
Turner, McClure & Rolston,
For Complainant.